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# **Crumbling Infrastructure, Crumbling Democracy: Infrastructure Privatization Contracts and Their Effects on State and Local Governance**

**Ellen Dannin**\*

## ABSTRACT

*Key arguments for privatizing public infrastructure range from providing money so cash-strapped governments can fix crumbling infrastructure and build much needed new infrastructure to shifting future financial risk from the public to a private contractor. The reality, though, is far different. Provisions commonly found in infrastructure privatization contracts make the public the guarantor of private contractors' expected revenues. Indeed, were it not for provisions that protect contractors from diminution of their expected returns, the contracts would be far shorter and much less complex. An effect of those contract provisions is to give private contractors a quasi-governmental status with power over new laws, judicial decisions, propositions voted on by the public, and other government actions that a contractor claims will affect toll roads and revenues. Giving private contractors such a role may well violate the non-delegation doctrine that bars private entities from exercising power that is inherently governmental.*

*This Article examines the operation and effects of three provisions that are commonly found in infrastructure contracts: (1) compensation events; (2) noncompetition provisions; and (3) the contractor's right to object to and receive compensation for legislative, administrative, and judicial decisions. The operation of these provisions gives private contractors power over decisions that affect the public interest and are normally made by public officials and subject to oversight, disclosure, and accountability—none of which apply to private contractors. The existence and operation of these provisions have gone virtually unexamined and undiscussed. Rather, discussions about infrastructure privatization have been narrowly focused on tolls, reflexive pro- or anti- private or public provisions, and spending or investment decisions on up-front payments.*

*Finally, this Article places infrastructure privatization in the larger context of funding and building infrastructure for the future. It identifies and critiques substantive and procedural issues that must be resolved if we are to have the high quality*

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*infrastructure necessary to meet this nation's needs and further its goals and if we are to achieve those goals by an open and democratic process.*

## I. AN INTRODUCTION TO INFRASTRUCTURE PRIVATIZATION

On July 24, 2008, the *Denver Post* reported that Coloradans were shocked to learn that the private contractors that had leased the Northwest Parkway had objected to improvements on West 160th Avenue and that the contractors had the legal right to object.<sup>1</sup> The contractors opposed improvements “because they might hurt the parkway financially.”<sup>2</sup> Colorado State Representative Frank McNulty declared: “The purpose of toll roads is to augment state transportation infrastructure, not act as a roadblock to the construction of new transportation infrastructure in the northwest metro area.”<sup>3</sup>

McNulty was wrong, and his comments came a year too late. Had he read the Northwest Parkway privatization contract<sup>4</sup> he would have learned that under its “adverse action” provisions, the contractors had the right to object to new or improved roads and mass transit systems. In addition, the contractors had the right to receive compensation for lost anticipated revenues if those roads or transit systems were built during the term of the ninety-nine year contract.<sup>5</sup> Most people would be surprised to learn that contracts to privatize major infrastructure, such as the Northwest Parkway, Chicago parking meters, proposed Indianapolis parking meters, and proposed Pennsylvania Turnpike contracts give private contractors these rights.<sup>6</sup>

Moreover, this was the case even though neither McNulty nor any member of the public could have raised objections to the contract before it was consummated, for the

<sup>1</sup> Jeffrey Leib, *Toll Firm Objects to Work on W. 160th: The “Non-Compete” Clause for the Northwest Parkway Raises Legislative Concerns*, DENVER POST, July 24, 2008, available at [http://www.denverpost.com/news/ci\\_9976830](http://www.denverpost.com/news/ci_9976830).

<sup>2</sup> *Id.*

<sup>3</sup> *Id.*

<sup>4</sup> The contract was between the Northwest Parkway Public Highway Authority, made up of local counties and cities (the City and County of Broomfield, City of Lafayette, and Weld County), and Brisas/CCR. *Brisa/CCR Selected as Preferred Concessionaire for NW Parkway Co*, TOLL ROADS NEWS, Apr. 11, 2007, <http://www.tollroadsnews.com/node/64>; Greg Avery, *Company Set to Pay up for Parkway*, BROOMFIELD ENTERPRISE, Mar. 23, 2007, [http://www.broomfieldenterprise.com/ci\\_12778502?IADID=Search-www.broomfieldenterprise.com-www.broomfieldenterprise.com](http://www.broomfieldenterprise.com/ci_12778502?IADID=Search-www.broomfieldenterprise.com-www.broomfieldenterprise.com).

<sup>5</sup> See Northwest Parkway Concession and Lease Agreement, Art. 14–Art. 15.1, Aug. 29, 2007, available at <http://www.northwestparkway.org/PDF/FinalCLA.pdf>.

<sup>6</sup> Examples of the contract provisions are discussed throughout this Article. Excerpts from several are also included in an Appendix to this Article.

See *Indy's “Son of Chicago” Parking Meter Lease to Be a Disaster for City*, URBANOPHILE, Sept. 7, 2010, <http://www.urbanophile.com/2010/09/07/indys-son-of-chicago-parking-meter-lease-to-be-a-disaster-for-city/>, for a comparison of the Chicago and Indianapolis parking meter contract terms. See also CHICAGO METERED PARKING SYSTEM CONCESSION AGREEMENT (Dec. 4, 2008) (on file with author). [hereinafter CHICAGO PARKING METER CONTRACT]; INDIANA TOLL ROAD CONCESSION AND LEASE AGREEMENT, BETWEEN IND. FIN. AUTH. AND ITR CONCESSION CO., available at <http://www.in.gov/ifa/2328.htm> (follow “Concession Agreement” hyperlink); Memorandum from Senator Mark Norris, Tennessee, Chair, Economic Development, Transportation & Cultural Affairs Committee, *Report of Activities of the Economic Development, Transportation & Cultural Affairs Committee*, to Members of the Executive Committee (July 16, 2007), available at [http://www.slcatlanta.org/chair-reports/2007\\_Chair\\_Reports/EDTCA\\_07\\_Rept.shtml](http://www.slcatlanta.org/chair-reports/2007_Chair_Reports/EDTCA_07_Rept.shtml) (discussing infrastructure privatization contract terms concerning compensation if competing roads are built).

terms were not released until after the deal was signed.<sup>7</sup> Agreeing to multi-decade infrastructure privatization contracts, despite providing no opportunity for public scrutiny of the contract terms or right to object, is not unique to the Northwest Parkway lease. For example, in 2008, Mayor Richard Daley insisted that the Chicago City Council approve the seventy-five year lease of the city's parking meters within two days after council members first saw the terms of the complex 279 page document.<sup>8</sup>

However, even when contract terms are made public, few people read or understand their effects. Reporter Steve Katula explained:

Virginia's contract for the Beltway HOT lanes are not just far from free to taxpayers and even worse if people carpool. The structure of the deal ultimately minimizes public outrage until it's too late, saddling taxpayers with a high bill and no voice.

....

Most Northern Virginians were completely unaware of the VDOT "Megaproject" prior to construction, and this illustrates the problematic nature of complex contracts that promise free stuff.

When taxpayer dollars are (supposedly) not involved, citizens (and even politicians) retract from the process, especially from boring contractual details . . . . [T]he supposedly free and complex, "black-box" nature of the HOT lanes deal served to discourage input and criticism. Despite VDOT following legally-mandated procedures for public input, the result was an opaque deal-making process, and a bad deal for Virginians.

....

But with the cards now on the table, one must ask what was wrong with the original estimates? Why the promise they could do the project on a totally private basis, followed by the late-in-the-game change? Why did politicians, VDOT, The Washington Post, and the public believe the almost magic promises, and why was there so little reaction when the

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<sup>7</sup> The author was following this issue at the time and was notified as soon as the signed contract was released. This was the first time the public had seen the terms. The contract received immediate strong criticisms by Coloradans, including the Colorado blogosphere. The next day, the posted contract and the summary of its provisions were altered so that they were viewable but could no longer be cut and pasted. The urls were also altered so that they ended with ".pdf.pdf." See shirah, *Failure is Not an Option . . . If You Lease a Colorado Tollroad* (Sept. 6, 2007, 1:55 PM) UNBOSSSED.COM, <http://www.unbossed.com/index.php?itemid=1708>; see also em dash, *Toll Road Sale Drives Hummer of a Question: Why?* (Sept. 6, 2007, 12:16 PM) UNBOSSSED.COM, <http://www.unbossed.com/index.php?itemid=1707>; shirah, *Highway Privatization, Taxes, and Picking the Public Pocket - Part II* (Mar. 2, 2008, 10:25 AM) UNBOSSSED.COM, <http://www.unbossed.com/index.php?itemid=1985>.

<sup>8</sup> See OFFICE OF THE INSPECTOR GEN. CITY OF CHI., REPORT OF INSPECTOR GENERAL'S FINDINGS AND RECOMMENDATIONS: AN ANALYSIS OF THE LEASE OF THE CITY'S PARKING METERS 1, 6 (2009) [hereinafter CHICAGO OFFICE OF THE INSPECTOR GEN. REPORT], available at <http://www.chicagoreader.com/features/blogs/pdf/IGO-CMPS-20090602.pdf>; Darrell Preston, *A Windfall for Investors, a Loss for Chicago: Critics Says the Windy City Will Lose Billions over the Life of a \$1.15 Billion Contract to Run the City's Parking Meters*, BUSINESSWEEK, Aug. 12, 2010, available at [http://www.businessweek.com/magazine/content/10\\_34/b4192044579970.htm](http://www.businessweek.com/magazine/content/10_34/b4192044579970.htm).

nature of the project funding changed, but the reward mechanism to the private contractor did not?<sup>9</sup>

In short, most people receive no information about important terms of these deals, either before or after they are consummated, ignore the subject as too complex for them to understand, or accept that cash-strapped governments have no alternatives to privatization if they are to fix their crumbling infrastructure.

The August 1, 2007 collapse of the I-35 bridge in Minneapolis<sup>10</sup> was a wake-up call about the danger of deferred maintenance which all states face today.<sup>11</sup> It is all but impossible to overstate the poor condition of our public infrastructure. When he introduced the yet to be enacted Surface Transportation Authorization Act of 2009, Congressman James Oberstar, then Chair of the House Committee on Transportation and Infrastructure, presented the bleak facts:

Currently, many segments of the nation's surface transportation infrastructure are reaching or have exceeded their useful design life. Today, almost 61,000 miles (37 percent) of all lane miles on the NHS [National Highway System] are in poor or fair condition; more than 152,000 bridges—one of every four bridges in the United States—are structurally deficient or functionally obsolete; and more than 32,500 public transit buses and vans have exceeded their useful life. The nation's largest public transit agencies face an \$80 billion maintenance backlog to bring their rail systems to a state of good repair and, within the next six years, almost every transit vehicle (55,000 vehicles) in rural America will need to be replaced. The American Society of Civil Engineers grades our surface transportation system as follows:

Roads D-  
Bridges C  
Transit D  
Rail C<sup>12</sup>

Deficient infrastructure is dangerous and expensive in terms of lives and injuries, impediments to commerce, inefficient and unnecessarily costly transportation, and degradation of the environment.<sup>13</sup>

No one doubts that we face an enormous task with respect to improving our infrastructure. For example, Pennsylvania has 128 bridges in its interstate system alone

<sup>9</sup> Steve Kattula, *Corporate Welfare and the Beltway HOT Lanes, Part 3: Don't Worry Until It's Too Late*, GREATER GREATER WASH., Nov. 18, 2009, <http://greatergreaterwashington.org/post.cgi?id=4102>.

<sup>10</sup> Demian McLean & Angela Greiling Keane, *Minnesota Bridge Fall Kills 4; Divers Seek Victims*, BLOOMBERG, Aug. 2, 2007, <http://www.bloomberg.com/apps/news?pid=20601087&sid=aG7N.nUqmdOQ#>.

<sup>11</sup> Celeste Pagano, *Proceed with Caution: Avoiding Hazards in Toll Road Privatizations*, 83 ST. JOHN'S L. REV. 351, 356–57 (2009) (discussing the dire state of U.S. infrastructure).

<sup>12</sup> HOUSE COMM. ON TRANSP. & INFRASTRUCTURE, *THE SURFACE TRANSPORTATION AUTHORIZATION ACT OF 2008: A BLUEPRINT FOR INVESTMENT AND REFORM 2* (2009) [hereinafter STAA BLUEPRINT] (on file with author).

<sup>13</sup> *Id.* at 1–2.

that are structurally deficient, fracture-critical, or functionally obsolete.<sup>14</sup> It also has no money to pay for repairs to its infrastructure system, to say nothing of paying for repairs to all of its other deficient public infrastructure. Pennsylvania is not alone.<sup>15</sup> Putting our national transportation infrastructure in good repair would require spending \$2.2 trillion over the next five years.<sup>16</sup> Unfortunately, that level of funding is simply not available. According to the Government Accountability Office (GAO):

The problem is simple: revenues from motor fuels taxes and truck-related taxes to support the HTF [Highway Trust Fund]—the primary source of funds for highway and transit—are not keeping pace with authorized spending levels. This problem was made dramatically apparent last summer when the Highway Account within the trust fund was nearly depleted. Despite an \$8 billion infusion from the General Fund of the Treasury in September 2008 to replenish the account, we find ourselves in the same predicament a year later.<sup>17</sup>

Using other funds from the federal budget to subsidize the Highway Trust Fund does not solve the problem of inadequate funds. Rather, it merely postpones our finance and infrastructure problems.<sup>18</sup>

It is easy to see why infrastructure privatization is the solution many states are turning to in order to repair, build, modernize, and operate highways and other infrastructure.<sup>19</sup> States and cities are also using the up-front payments that are part of many infrastructure privatization deals to address their budget deficits.<sup>20</sup> In addition to providing funds, privatization is popularly seen as a way to shift future financial risk to the private contractor.<sup>21</sup>

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<sup>14</sup> PA. TPK. COMM'N, PA. DEP'T OF TRANSP., SUPPLEMENTAL INFORMATION ON THE NEEDS AND FUNDING STATUS OF INTERSTATE 80 IN PENNSYLVANIA 7 (2009).

<sup>15</sup> Michigan is but one of many other states whose situation is also dire. See MICH. TRANSP. FUNDING TASK FORCE, TRANSPORTATION SOLUTIONS: A REPORT ON MICHIGAN'S TRANSPORTATION NEEDS AND FUNDING ALTERNATIVES vi–xi (2008), available at [http://www.michigan.gov/documents/mdot/MDOT\\_TF2\\_Entire\\_Report\\_255609\\_7.pdf](http://www.michigan.gov/documents/mdot/MDOT_TF2_Entire_Report_255609_7.pdf).

<sup>16</sup> STAA BLUEPRINT, *supra* note 12, at 12.

<sup>17</sup> U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-09-845T, HIGHWAY TRUST FUND: OPTIONS FOR IMPROVING SUSTAINABILITY AND MECHANISMS TO MANAGE SOLVENCY I (2009), available at <http://www.gao.gov/new.items/d09845t.pdf> [hereinafter GAO REPORT HIGHWAY TRUST FUND, GAO-09-845T]. See generally FED. HIGHWAY ADMIN., U.S. DEP'T OF TRANSP., FINANCING FEDERAL-AID HIGHWAYS, THE HIGHWAY TRUST FUND, FHWA-PL-99-015 (1999), available at <http://www.fhwa.dot.gov/reports/fifahiwy/fifahi05.htm>. (providing an historical overview of funding for federal aid highways).

<sup>18</sup> See *infra* Part IV, for a more detailed discussion of the issue of taxes to fund infrastructure repair and construction.

<sup>19</sup> See Jewel Edwards, *Public-Private Partnerships: Georgia, California, Arizona Prepare to Take On More Public-Private Partnership Projects*, BNA INFRASTRUCTURE INVESTMENT & POLICY REPORT, Sept. 28, 2009.

<sup>20</sup> See Daniel Schulman, *Highway Privatization: A Dead End?* MOTHER JONES, May 22, 2009, <http://www.motherjones.com/mojo/2009/05/highway-privatization-dead-end> (arguing that the Indiana toll road was purchased by a private entity for a price far below its value).

<sup>21</sup> SEAN SLONE, TRANSPORTATION AND INFRASTRUCTURE FINANCE: A CSG NATIONAL REPORT 24 (N.D.), available at <http://www.csg.org/pubs/Documents/TransportationInfrastructureFinance.pdf>; SPOCK SOLUTIONS INC. & JACOBS, KAN. TPK. AUTH, KAN. DEP'T OF TRANSP., USING TOLLS TO SUPPORT NEEDED

However, not everyone is sanguine about infrastructure privatization as a solution to these problems. While the public wants good transportation, people do not necessarily embrace infrastructure privatization.

Look no further than Indiana, where Governor Daniels's popularity ratings plunged in the wake of the sale of the toll road amid a hue and cry about foreign firms' owning our roads. And as the self-styled populist Lou Dobbs asked, "What right do they have to sell something that belongs to the taxpayer?"<sup>22</sup>

Macquarie, one of the international firms engaged in infrastructure privatization, has even been accused of running "an old-fashioned Ponzi scheme," rather than inventing a new way to finance infrastructure.<sup>23</sup>

An August 2010 Bloomberg Businessweek report on the Chicago parking meter deal captures the many ways in which government and investors are affected by these deals.<sup>24</sup> According to Bloomberg, it is estimated that Chicago drivers will pay the private parking meter contractor more than \$11.6 billion in parking fees over the next 75 years.<sup>25</sup> That is more than ten times the \$1.15 billion the City of Chicago received for the concession in 2008.<sup>26</sup> The Morgan Stanley led partnership's 2010 documents to support the sale of \$500 million of notes say that they expect to earn a profit of \$9.58 billion before interest, taxes, and depreciation.<sup>27</sup> That investment group is currently using aggressive parking-fee hikes to make a return of more than 80 cents per dollar of projected revenue, twenty times the 4.84 cents on a dollar earned by the concession owner at O'Hare and Midway airports in 2009.<sup>28</sup>

In 2007, Congressman Oberstar, Chair of the House Committee on Transportation and Infrastructure, and Congressman Peter DeFazio, Chair of the Subcommittee on Highways and Transit, wrote governors, state legislators, and state transportation officials that privatizing the nation's transportation infrastructure was not in the public's interest.<sup>29</sup>

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TRANSPORTATION PROJECTS: A RESOURCE FOR KANSAS POLICYMAKERS 3-32-3-33 (2008) [hereinafter KANSAS POLICYMAKER REPORT], *available at* <http://www.kansastlink.com/downloads/VI%20Using%20Tolls%20to%20Support%20Needed%20Transportation%20Projects.pdf> ("By moving to private participation in toll roads, the public benefits from private assumption of risk as well as from the availability of private capital, and it is appropriate that investors be paid to produce those public benefits.").

<sup>22</sup> Bethany McLean, *Would You Buy a Bridge from this Man?*, CNNMONEY.COM, Oct. 2, 2007, [http://money.cnn.com/2007/09/17/news/international/macquarie\\_infrastructure\\_funds.fortune/index.htm](http://money.cnn.com/2007/09/17/news/international/macquarie_infrastructure_funds.fortune/index.htm); see Daniel Schulman & James Ridgeway, *The Highwaymen: Why You Could Soon Be Paying Wall Street Investors, Australian Bankers, and Spanish Builders for the Privilege of Driving on American Roads*, MOTHER JONES, Jan./Feb. 2007, <http://www.motherjones.com/news/feature/2007/01/highwaymen.html>; Tim Gray, *Is It Time to Add a Parking Lot to Your Portfolio?*, N.Y. TIMES, Dec. 31, 2006, *available at* <http://www.nytimes.com/2006/12/31/business/yourmoney/31infra.html>.

<sup>23</sup> McLean, *supra* note 22.

<sup>24</sup> Preston, *supra* note 8.

<sup>25</sup> *Id.*

<sup>26</sup> *Id.*

<sup>27</sup> *Id.*

<sup>28</sup> *Id.*

<sup>29</sup> Letter from Representative James L. Oberstar, Chairman of the House Transp. & Infrastructure Comm. & Representative Peter A. DeFazio, Chairman of the Subcomm. on Highways and Transit, to Governors, State Legislators, and State Transportation Officials (May 10, 2007) (on file with author).

In 2008, Oberstar and DeFazio wrote then Secretary of Transportation Mary Peters, a proponent of privatization, that specific aspects of infrastructure privatization, including noncompete agreements, undermined the nation's transportation system.<sup>30</sup>

On June 22, 2009, Oberstar introduced the draft Surface Transportation Authorization Act of 2009, a bill intended to

transform Federal surface transportation to a performance-based framework to reduce fatalities and injuries on our Nation's highways, address the mobility and access needs of people and goods, improve the condition, performance, and connectivity of the United States intermodal surface transportation system, provide transportation choices for commuters and travelers, promote environmental sustainability, public health, and the livability of communities, support robust investment in surface transportation, and for other purposes.<sup>31</sup>

Among its innovations, the Bill responded to concerns over questionable infrastructure privatization by proposing the creation of an "Office of Public Benefit" (OPB) within the Federal Highway Administration. The OPB was to (1) be a one-stop shop for federal toll authority; (2) keep Interstates toll-free except under narrowly defined circumstances; (3) require transportation alternatives and public protections where a Federal-aid Highway is tolled; and (4) require public protections within highway privatization contracts.<sup>32</sup> The OPB was to be charged with providing "for the protection of the public interest in relation to highway toll projects and public-private partnership agreements on Federal-aid highways."<sup>33</sup> Congressman James L. Oberstar, had played an important role in infrastructure policy; however, after introducing the bill, Representative Oberstar concluded that it would not be possible to get Congress to pass the Surface Transportation Authorization Act of 2009 during that term. Oberstar lost his seat in the 2010 election,<sup>34</sup> while the Democratic Party lost its majority in the House, so it seems unlikely anyone will now champion the bill.

Our country faces many challenges but with far fewer resources than at any other time in decades. Solutions are proposed, but not all are appropriate. If there is to be an informed choice, there must be an informed public. The public deserves and needs to understand how these multi-billion dollar contracts affect vital national infrastructure and how they affect the public interest. This Article's contribution to that conversation is to first discuss key infrastructure privatization contract provisions and their operation. It

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<sup>30</sup> Letter from Representative James L. Oberstar, Chairman of the House Transp. & Infrastructure Comm. & Representative Peter A. DeFazio, Chairman of the Subcomm. on Highways and Transit, to Secretary Mary Peters, Secretary, Dep't. of Transp. (Nov. 4, 2008) (on file with author).

<sup>31</sup> STAFF OF H. COMM. ON TRANSP. & INFRASTRUCTURE, 111TH CONG., SURFACE TRANSPORTATION AUTHORIZATION ACT OF 2009 § 1204 (Comm. Print 2009).

<sup>32</sup> STAA BLUEPRINT, *supra* note 12, at 31–33.; *see also* STAFF OF H. COMM. ON TRANSP. & INFRASTRUCTURE, 111TH CONG., SURFACE TRANSPORTATION AUTHORIZATION ACT OF 2009 § 1204 (Comm. Print 2009).

<sup>33</sup> STAFF OF H. COMM. ON TRANSP. & INFRASTRUCTURE, 111TH CONG., SURFACE TRANSPORTATION AUTHORIZATION ACT OF 2009 § 1204.

<sup>34</sup> *Oberstar Suggests 1-Year Extension, Reflects on 18 Terms in House*, STATES NEWS SERVICE, Nov. 22, 2010.



then assesses innovations in the proposed Surface Transportation Authorization Act of 2009 and proposes ways to provide high quality transportation infrastructure.<sup>35</sup>

## II. READING INFRASTRUCTURE PRIVATIZATION CONTRACTS

It is no surprise that infrastructure privatization contracts are not widely read. They are specialized, complex legal documents that tend to run over 100 pages, not including attached documents that are referred to in the contract.<sup>36</sup> In general, the terms that have received the most public attention have been the amount of up-front money paid by the private contractor and the contractor's rights to impose or raise tolls or other user fees.<sup>37</sup> Missing from public discussion and scrutiny have been the contract terms that make government parties to infrastructure privatization contracts the insurer of the private contractor's financial success. The three most commonly found provisions that can require governments to reimburse private contractors for lost anticipated revenue are (1) compensation events; (2) noncompetition provisions; and (3) "adverse action" or "stabilization" clauses. Failing to have a national conversation about these terms and their effects has left the public ignorant as to how these contract terms shift power over government policy and actions to private contractors. The effects of these overlooked terms will be felt long after the contracts end. These provisions are commonly found across different types of infrastructure contracts, and their order and a large percentage of their wording tends to be the same. For example, just the table of contents for the Northwest Parkway and the Pennsylvania Turnpike contracts are at least 70% identical and Article 14 in the contracts for the Colorado Northwest Parkway, Pennsylvania Turnpike, and Chicago Parking Meters all concern "adverse actions." Given the prevalence of these terms in existing contracts, it seems likely that they will be found in many privatization contracts and, as a result, state, county, and city power to govern will be shifted to private contractors.

### A. Compensation Events

A private contractor is only interested in a deal if it concludes that the investment is likely to make more money compared to other available investments. It is curious, then, that the private sector has become interested in infrastructure privatization in the United States. A 1996 study of fourteen urban toll roads by J. P. Morgan Securities found that only two of the projects had revenues that exceeded projections during the first four years of operation, and ten projects' "revenues fell short by 20 percent to 75

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<sup>35</sup> See discussion *infra* Part IV.B.

<sup>36</sup> The proposed Pennsylvania Turnpike Contract with all attachments is 686 pages. See [Proposed] Pennsylvania Turnpike Contract (2008) (on file with author). The terms public-private partnerships, PPPs, P3s, and infrastructure privatization are often used interchangeably.

<sup>37</sup> See AM. FED'N OF STATE, CNTY. & MUN. EMP., TRANSPORTATION ASSETS: CASH COWS? (2008), available at <http://www.afscme.org/docs/08LegAgenda-transportation.pdf> (calling into question the wisdom of privatizing the operations of public roads); NAT'L ASS'N OF TRUCKSTOP OPERATORS, INTERSTATE TOLLS AND HIGHWAY PRIVATIZATION (2009), [http://www.natso.com/AM/Template.cfm?Section=Top\\_NATSO\\_Issues&Template=/CM/ContentDisplay.cfm&ContentID=8128&FusePreview=True&WebsiteKey=e91dcade-9ead-43ab-b6bc-c608fd2a3c34](http://www.natso.com/AM/Template.cfm?Section=Top_NATSO_Issues&Template=/CM/ContentDisplay.cfm&ContentID=8128&FusePreview=True&WebsiteKey=e91dcade-9ead-43ab-b6bc-c608fd2a3c34) (noting several reasons why tolls do not create positive outcomes for interstate travelers, businesses along tolls roads, and interstate businesses).

percent.”<sup>38</sup> The Congressional Budget Office concluded that the “study may prompt potential lenders and equity investors to take greater care in scrutinizing projections of traffic and revenues and to require government funding or financial guarantees to reduce the risk of investing, especially at the earliest and riskiest stages of the project.”<sup>39</sup> Despite these findings and recommendations, problems with faulty traffic and revenue predictions have continued.<sup>40</sup>

Given those results, it is surprising that private contractors continue to be interested in infrastructure privatization. Toll road revenues can not be guaranteed as long as revenue projections must be based on uncertain predictions as to the many factors that can affect driving.<sup>41</sup> Yet, despite the uncertainty, private contractors continue to be interested in multi-decade deals when contracts with shorter terms would lessen the problems of forecasting revenues. However, shorter contracts could mean losing the benefit of federal tax provisions that allow contractors to take advantage of the ability to take highly accelerated depreciation of the infrastructure. Those provisions are only available if the contract term is so long it exceeds the useful life of the infrastructure and effectively makes the private contractor the owner. In other words, infrastructure privatization contractors have opted for a mix of ways to generate revenue other than charging tolls or fees. Their revenues include government funding through the tax system and revenue guarantees under the contract.<sup>42</sup>

For example, in 2008, the State of Indiana reimbursed the private Indiana Toll Road operator \$447,000 for waiving tolls of people evacuated during severe flooding.<sup>43</sup> Had the road not been privatized, the state would have waived the tolls and simply collected less revenue. The contract, however, put the contractor in a much better financial situation than the state, because it did not lose toll revenues. In effect, these reimbursement terms make government the contractor’s insurer and guarantor. The terms may even create financial disincentives to government’s taking life-saving action. That is, a state or local government that is so short of money that it must “sell” valuable public infrastructure has more to consider in a disaster than just saving lives. If it needs to ask how much protection it can afford, it may, on the margins, be tempted to decide against taking actions that will require reimbursing the contractor.

Indeed, the contractual guarantees can put infrastructure contractors in a better revenue position than its government partner had it continued to control the infrastructure. For example, in November 2010, Chicago store owners along Touhy

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<sup>38</sup> CONG. BUDGET OFFICE, TOLL ROADS: A REVIEW OF RECENT EXPERIENCE 18 (1997), available at <http://www.cbo.gov/ftpdocs/40xx/doc4014/1997doc03-Entire.pdf>.

<sup>39</sup> *Id.*

<sup>40</sup> See *infra* text accompanying notes 156–159.

<sup>41</sup> Among the factors likely to affect driving and revenues, I would include interest rates; the attractiveness of alternative investments; local, national, and world economies; and new modes of transportation. Traffic can decline due to gas shocks; higher unemployment; shifts to mass transit; changing housing patterns; and the economy in general.

<sup>42</sup> See discussion *infra* notes 83–85.

<sup>43</sup> PHINEAS BAXANDALL, KARI WOHLSCHEGEL & TONY DUTZIK, U.S. PIRG EDUCATION FUND, PRIVATE ROADS, PUBLIC COSTS: THE FACTS ABOUT TOLL ROAD PRIVATIZATION AND HOW TO PROTECT THE PUBLIC 19 (2009), available at

<http://www.uspirg.org/uploads/rX/yT/rXyTdCxIacJTXJi3Cm-W1w/Private-Roads-Public-Costs-Updated.pdf>; see Yvette Shields & Caitlin Devitt, *Midwest Bond-Watch*, BOND BUYER, Sept. 30, 2009; *State to Pay for Waiver Fees on Toll Road*, ASSOCIATED PRESS, Sept. 20, 2008.

Avenue found parking meters being installed where none had ever been. Their ward's alderman explained that the parking meter privatization contract required that there be "no net loss in parking spots for Chicago Parking Meters LLC. 'They're guaranteed X number of spots so if you remove them from one place, you have to replace them in another.'"<sup>44</sup> The city, of course, had no such meter or revenue replacement guarantee. Much of infrastructure privatization contracts concerns contractor revenue guarantees. From the point of view of the government partner, they operate as a form of penalty for government's taking actions in the public interest.

While money certainly matters, it is equally important to consider the effects these terms are likely to have. First, although the documents take the form of contracts, they are not simple bilateral contracts for a one-shot deal. Both types of agreements are an exchange of money for providing a product or service at a specific time. However, infrastructure privatization contracts concern more than the delivery of a physical product; they control the operation of and care for vital and expensive infrastructure for many decades.<sup>45</sup> That infrastructure was paid for with public money and is part of a link in a larger system intended to promote the well being of the public, not to be a direct source of private profits.

Second, under these contracts, the damage calculations are anything but simple. Rather, they are based on multi-decade revenue predictions, whose accuracy cannot be verified. Both problems are the result of opting to lock in terms governing the relationships for the life of a long-term contract, rather than using a flexible method for dealing with uncertain events into the distant future. The value of the contract thus depends on accurately predicting and accounting for income, expenses, goals, quality of commitment to the relationship, others' needs and temptations, the economy, acts of nature, and how to deal with problems that arise in any of these areas. From the contractor's point of view, it also depends on assurance that the government party will pay, and will do so with as little cost of getting that payment as possible.

A good example of the challenges just described can be found in Section 3.7(a)(1) on "Rights of the [Pennsylvania] Commonwealth to Access and Perform Work on the Turnpike" in the proposed Pennsylvania Turnpike contract. The Commonwealth retains rights "to inspect the Turnpike or determine whether or not the Concessionaire is in compliance with its obligations under this Agreement or applicable Law pursuant to Section 8.3."<sup>46</sup> Another provision allows the Commonwealth to enter the Turnpike if the private contractor has defaulted, so that the Commonwealth can "make any necessary repairs to the Turnpike, perform any work therein and take any reasonable actions in connection therewith, including remediation of Hazardous Substances, pursuant to Section 16.1 (b)(iii)."<sup>47</sup> In other words, as the lessor, Pennsylvania needed to retain rights to *enter* the highway after it was privatized in order to ensure that the private contractor has kept its side of the bargain.

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<sup>44</sup> *Parking Pay Box Pops Up To Dismay Of Businesses*, CBS CHICAGO, Nov. 9, 2010, <http://chicago.cbslocal.com/2010/11/09/parking-pay-box-pops-up-to-dismay-of-businesses/>.

<sup>45</sup> See *infra* text accompanying notes 77–80.

<sup>46</sup> [Proposed] Pennsylvania Turnpike Contract § 3.7(a) (i) 42 (2008) (on file with author). Although the title says "Final" the contract was proposed but not approved by the Pennsylvania legislature. As a result, it has never come into force.

<sup>47</sup> [Proposed] Pennsylvania Turnpike Contract § 3.7(a) (ii) 42 (2008) (on file with author).

The contracts treat the government more as a private landlord. There is a difference, however, in limiting the right of a landlord to enter a tenant's property and limiting the government from entering a privatized highway to deal with events such as emergencies. The Commonwealth's right to enter is heavily constrained by limits and exceptions that can become a "Compensation Event" requiring the government to pay "Concession Compensation" to the contractor. It is helpful to read some short excerpts as background for understanding the effects these terms can have:

"Concession Compensation" means, with respect to a Compensation Event, compensation payable by the Commonwealth to the Concessionaire in order to restore the Concessionaire to the same after-Tax economic position that the Concessionaire would have been in if such Compensation Event had not occurred . . . .<sup>48</sup>

"Compensation Event" means (i) any applicable entry on the Turnpike by the Commonwealth pursuant to Section 3.7(a)(v) through Section 3.7(a)(ix), *provided* that the Concessionaire's use of the Turnpike as a highway is materially impaired resulting in Losses or reduced Turnpike Revenues, (ii) the Concessionaire's compliance with or the implementation of a Required Modification pursuant to Section 5.2, (iii) the Concessionaire's compliance with or the implementation of any modified or changed Operating Standard (as contemplated by Section 6.3(b)), (iv) the termination of an agreement with a Vendor as contemplated in Section 7.2(d), (v) the occurrence of an Adverse Action as contemplated in Article 14, (vi) the circumstances described in each of Section 2.5(i), Section 4.1(a), Section 4.2, Section 5.2 and Section 15.2(d), (vii) any breach of the covenant set forth in Section 3.10(b) or (viii) the occurrence of a Commonwealth Default as contemplated in Article 16.<sup>49</sup>

These clauses are not easy reading even for attorneys. They must be interpreted by referring to many other parts of the contract, which, in turn, require referring to other sections. Many of the terms have special meanings that require referring to the contract's lengthy definition section. Other difficulties arise from terms such as "material" and "breach." They are legal terms of art, and they are also highly subjective concepts. Thus, contract terms that are included to provide the contractor with certainty that it will receive its anticipated revenue create new uncertainties for the government and the public.

In these days of serial contracting,<sup>50</sup> it may be difficult for a state to directly control the actions of those who perform duties in the name of the public or on behalf of the private contractor. For example, it has long been common to hire general and sub-contractors to handle construction, repairs, and other specialized tasks. But what happens

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<sup>48</sup> [Proposed] Pennsylvania Turnpike Contract Definition § 6 (2008) (on file with author).

<sup>49</sup> *Id.*

<sup>50</sup> Private or public entities may contract out a project or specific functions in areas where they lack expertise, where another entity can do the work for less, where a task is short term, where there is a hiring freeze, or if, for other reasons, new employees cannot be hired. In recent years, it has become common for contractors to employ subcontractors to help carry out oversight and management of these specific projects or functions, thus increasing the structural complexity of projects.

when a state or local government that has privatized a road has also contracted out its services for dealing with an emergency? How can the state or local government ensure that entry onto the highway by contractors hired to do a specific job does not cause a compensation event? How can the government ensure that its private emergency contractor gives notice reasonable under the circumstances? The possibilities for a complex chain of litigation are obvious. It is, therefore, no surprise that Mayer Brown, a law firm with an international privatization practice, promotes both its transactional and litigation experience in this area.<sup>51</sup>

“Compensation events” arise from what, before privatization, were simple acts whose sole purpose was the upkeep of the infrastructure or public safety needs, such as inspecting the quality of the roadbed or responding to emergencies. Chicagoans learned about compensation events when CBS reported that the city’s parking meter contract required reimbursement for events like repairing streets. Public records showed that in the first quarter of 2009, the city was liable to the parking meter contractor for more than \$106,000 in lost income during the slow months for street repair and street closings for festivals, parades, and holidays, as well as repairs and maintenance. At that rate, it is not unreasonable to predict that Chicago will owe roughly \$500,000 a year to the private contractor.<sup>52</sup> However, in some areas where parking rates are higher or where paid parking hours are longer, reimbursements could be much higher.<sup>53</sup> A lawyer suing the city over the parking meter deal estimated that it could cost “\$559,057 a year, or about \$8,000 a space” to reimburse the company if the 68 “most valuable spaces in the city . . . were out for a year.”<sup>54</sup> Thus, while the city would receive less revenue when parking meters are out of service due to repairs, the contractor’s revenues continue.

Moreover, infrastructure privatization contracts mean that even basic maintenance can create situations under which a government entity owes compensation to private contractors. Had the legislature approved it, the proposed Pennsylvania Turnpike contract would have required the Commonwealth to pay the private contractor if entry onto the Turnpike by the Commonwealth was not at a reasonable time or if the Commonwealth had failed to give reasonable prior notice. Indeed, even though the contract says that the Commonwealth can enter the Turnpike to respond to emergencies, those rights are limited by conditions that can require compensation. For example, § 3.7(a)(iii) allows access by emergency crews, but only if the Commonwealth *reasonably* believes that an emergency exists, that the situation is defined in the contract as one permitting entry, and the method of entry complies with other parts of the contract,

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<sup>51</sup> “We carry out contract and bid-form drafting, as well as the preparation of most construction-related agreements, forms and documents. Additionally, we offer a strong litigation practice to assist in construction auditing and with representing clients in the trial of complex design and construction claims. These consulting, negotiation and contracting services have included sophisticated risk and risk-avoidance advice.” MAYER BROWN, FACT SHEET: TRANSPORTATION INFRASTRUCTURE: PORTS, PORT-RELATED FACILITIES AND INTERMODAL PROJECTS 2 (2009), [http://www.mayerbrown.com/infrastructure/MB\\_Transportation\\_Infrastructure.pdf](http://www.mayerbrown.com/infrastructure/MB_Transportation_Infrastructure.pdf) (last visited Sept. 19, 2010) [hereinafter MAYER BROWN FACT SHEET].

<sup>52</sup> *Parking Meter Firm Gets Paid Even When Streets Closed*, CHI. PRESS RELEASE SERVICES, <http://chicagopressrelease.com/press-releases/parking-meter-firm-gets-paid-even-when-streets-are-closed> (last visited Jan. 26, 2011).

<sup>53</sup> *See id.*

<sup>54</sup> *Id.*

including giving notice that is “practicable under the circumstances.” Consider the worst case scenario of a national emergency. When no infrastructure privatization contracts are involved, emergency responders can focus solely on how best to cope with the situation. When a highway is privatized, emergency responders must parse contract language and negotiate that access be given even to people who have no transponder or money to pay the toll.

Clashes between the private sector and public welfare are not hypothetical concerns. For example, in 2006, the Indiana Toll Road contractor installed sand-filled barrels in Toll Road turn-arounds to prevent drivers from using them.<sup>55</sup> However, those turn-arounds were created to get emergency crews to accidents as quickly as possible. State officials and emergency services were not consulted or even informed of the decision to block the turn-arounds, and it was months before the contractor agreed to remove the barrels.<sup>56</sup> These problems could have been avoided had the contractor met its contractual obligation to prepare an emergency response plan for the Toll Road. Thus, privatizing the road left the public with less protection and with its needs for safety not being taken into consideration, despite the requirements of the Toll Road lease.<sup>57</sup>

Contract provisions also create conditions that pit profits against public safety. For example, § 3.7 of the Pennsylvania Turnpike contract permits entry onto the road for specific purposes, such as ensuring compliance with safety requirements or in the case of emergencies. However, the contract terms mean that performing those public safety functions may impose extra costs on the government. It must read the contract carefully, adjust the way it performs its functions to avoid incurring an obligation to compensate the private contractor, and budget for Concession Compensation.

Fear of litigation and of the cost of litigation increases when it is difficult to determine rights. Infrastructure privatization contracts contain exceptions upon exceptions, complex language, and subjective standards that require that government alter and limit the way it acts. Thus, when faced with a claim for compensation for an unreasonable entry by a contractor with deep experience administering these contracts, the government, which lacks expertise in this area, may feel forced to settle rather than incur the cost of litigating and losing. However, if settlements are reached without evidence that proves an obligation to pay and that specific revenues have been lost, the government may have overpaid.

Indeed, the occurrence of events, such as the flooding that required using the Indiana Toll Road for evacuation, is predictable and should not impose costs on the

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<sup>55</sup> Joshua Stowe, *U-Turn Safety Barriers on Toll Road Finished: Emergency Crews Still Training on Median Bypass*, SOUTH BEND TRIB. (INDIANA), Nov. 11, 2006 at B-3; Abigail Field, Legislative Advocate, N.J. Pub. Interest Research Group Citizen Lobby, Presentation to the IMN National Public-Private Partnership Symposium (March 30, 2007), available at [http://www.njpirg.org/issues/save-our-turnpike/njpirg-citizen-lobbys-presentation-to-the-imn-national-public-private-partnership-symposium-march-30-2007-washington-d.c?\\_\\_utma=1.1466379737.1290455600.1290455600.1290455600.1&\\_\\_utmb=1.4.10.1290455600&\\_\\_utmc=1&\\_\\_utmz=1.1290455600.1.1.utmcsr=google|utmccn=%28organic%29|utmcmd=organic|utmctr=indiana%20toll%20road%20turn%20arounds%20blocked%20avoid%20tolls&\\_\\_utmv=-&\\_\\_utmk=121018632](http://www.njpirg.org/issues/save-our-turnpike/njpirg-citizen-lobbys-presentation-to-the-imn-national-public-private-partnership-symposium-march-30-2007-washington-d.c?__utma=1.1466379737.1290455600.1290455600.1290455600.1&__utmb=1.4.10.1290455600&__utmc=1&__utmz=1.1290455600.1.1.utmcsr=google|utmccn=%28organic%29|utmcmd=organic|utmctr=indiana%20toll%20road%20turn%20arounds%20blocked%20avoid%20tolls&__utmv=-&__utmk=121018632).

<sup>56</sup> Theodore Kim, *States Considering Privatizing Highways Can Study Indiana Toll Road Experience*, USA TODAY, Oct. 17, 2006, at 10A, available at [http://www.usatoday.com/news/nation/2006-10-16-indiana-roads\\_x.htm](http://www.usatoday.com/news/nation/2006-10-16-indiana-roads_x.htm).

<sup>57</sup> Stowe, *supra* note 55.

government. Businesses have deep experience in protecting themselves from devastating losses caused by weather or other disasters. One way is to factor these events into the cost of the contract as part of doing due diligence. In addition, prudent people and institutions purchase insurance to cover these sorts of contingencies. Privatization contractors should do the same rather than making the government their insurer. It may even be that the contractor has done its due diligence and included these events in its assessment of costs and benefits. If so, the contractor is paid twice, and the public's financial benefit from the contract is decreased.

But far more serious is the effect of concession compensation on the protections the public expects from government. Consider the effect on the right of fire, police, and medical crews to enter a road to deal with emergencies when there is no contract and no charge for entry.<sup>58</sup> Consider the effect on them when that right of entry is lost unless the Commonwealth uses "its reasonable efforts to minimize (i) the duration and scope of any such declaration and (ii) the adverse impact that any such declaration may have on the Turnpike Operations."<sup>59</sup> State, county, and city attorneys will have been briefed on their obligations. They, in turn, must instruct police, emergency, and fire departments that, when there is an accident on the Turnpike, emergency responders must consider more than just getting to the scene as quickly as possible to render aid. Rather, they will be instructed that they must, in every instance, make "reasonable efforts" to minimize the impact of their efforts on Turnpike tolls and to document how their actions have minimized any negative effects. The result will be hesitation and new obligations that can slow and impede emergency responses. Equally likely is that there will be no instruction, and eventually, when a compensation claim is made, the public will learn that it costs more money to respond to emergencies and to provide for the public welfare.

### *B. Noncompetition Agreements: Hidden Costs of Infrastructure Privatization*

Destroying competition would seem to undermine the basic argument for private operation: being able to choose goods and services from among competitors in the free market spurs better performance and drives down costs. Indeed, it is choice and competition that provide accountability in the private sector.<sup>60</sup> Noncompetition provisions, however, forbid competition and do away with choice. As a result, they eliminate these important spurs to better performance and lower cost. Despite this, a 2004 U.S. Department of Transportation report said that the powers of a state's lead agency responsible for promoting public-private partnerships "should include the power . . . to establish a geographic noncompete zone."<sup>61</sup>

Although noncompete provisions are commonly found in infrastructure privatization agreements, they are not limited to privatized roads. Denver's E-470 was

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<sup>58</sup> Proposed Pennsylvania Turnpike Contract § 3.18 (2008) (on file with author).

<sup>59</sup> *Id.*

<sup>60</sup> See Ellen Dannin, *Red Tape or Accountability: Privatization, Public-ization, and Public Values*, 15 CORNELL J.L. & PUB. POL'Y 111, 136–48 (2006) (contrasting private versus public sector accountability).

<sup>61</sup> U.S. DEPT. OF TRANSP., REPORT TO CONGRESS ON PUBLIC-PRIVATE PARTNERSHIPS (2004) [hereinafter DOT REPORT], available at <http://www.fhwa.dot.gov/reports/pppdec2004/>; see also EDWARD FISHMAN, NATIONAL COOPERATIVE HIGHWAY RESEARCH PROGRAM, TRANSPORTATION RESEARCH BOARD, LEGAL RESEARCH DIGEST 51 35–36 (James B. McDaniel ed. 2009) [hereinafter NCHRP REPORT], available at [http://onlinepubs.trb.org/onlinepubs/nchrp/nchrp\\_lrd\\_51.pdf](http://onlinepubs.trb.org/onlinepubs/nchrp/nchrp_lrd_51.pdf) (noting that the private equity and its financial backers often view noncompete agreements as essential).

built by a consortium of local governments, and their agreement required lowering speed limits on nearby Tower Road from 55 to 40 m.p.h. and installing stop lights on 96th, 104th, and 112th Avenues.<sup>62</sup> Indeed, noncompetition provisions are included in infrastructure privatization contracts in the United States and abroad, and actions to discourage drivers from using alternate roads are regularly taken in order to make the privatized road the only option.

Another common method of eliminating competition is “traffic calming.” In Sydney, Australia, for example, a community liaison group member testified that the narrowing of lanes on adjacent, free roads came as a shock to area residents:

‘Suddenly overnight, like mushrooms, concrete barriers are built,’ Suzanne O’Connor testified. ‘They were very keen on traffic calming, which apparently is jargon for funneling. So there was a lot of jargon, a lot of English being abused, again I think . . . in an attempt to keep the implications hidden.’<sup>63</sup>

If conditions on potential competing roads or other infrastructure are sufficiently unpleasant, the effect of a noncompete provision can be achieved, even if none is included in the contract.

An example of another anti-competitive measure whose effects are similar to traffic calming is a contract provision that allowed a private contractor to build express toll lanes in the median of California SR-91, but forbade the government from performing repairs and upkeep on the parallel public, nontolled lanes:

Despite the successful implementation of the SR-91 Express Lanes project, the PPP arrangement ran into problems several years later as concerns grew about the contractual restrictions on capacity improvements in the absolute protection zone and changes in the ownership of the private consortium. Several lawsuits were filed against Caltrans and the private contractor as a result of the noncompete restriction, and Caltrans ultimately was forced to make improvements to the tollfree lanes on SR-91. In 2002, as a result of the lawsuits and growing public opposition, the California legislature passed Assembly Bill 1010 (AB 1010) which authorized OCTA [Orange County Transportation Authority] to buy out the private franchise, eliminated the absolute protection zone, and required the facility to become toll-free at the end of the 35-year term. AB 1010

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<sup>62</sup> *Colorado City Ruins Road to Boost Toll Revenue: Commerce City, Colorado Non-Compete Agreement Lowered the Speed Limit and Installed Unneeded Traffic Signals to Force People onto the E-470 Toll Road*, THENEWSPAPER.COM, Aug. 15, 2005, <http://www.thenewspaper.com/news/05/599.asp>; see *Texas: Speed Limit May be Lowered to Boost Toll Revenue*, THENEWSPAPER.COM, Oct. 19, 2007, <http://thenewspaper.com/news/20/2025.asp>.

<sup>63</sup> *Australia: Traffic Lights Modified to Funnel Traffic Into Toll Tunnel*, THENEWSPAPER.COM, Feb. 3, 2006, <http://www.thenewspaper.com/news/09/936.asp>; see also Elliott D. Sclar, Professor of Urban Planning, Sch. of Int’l and Pub. Affairs, Columbia Univ., Address to the Association of Collegiate Schools of Planning: The Political-Economics of Private Infrastructure Finance: The New Sub Prime 14–16 (Oct 1, 2009) [hereinafter Sclar Address] (describing commonly used methods of coercing drivers to use privatized toll roads).



prohibits OCTA from transferring the franchise and prohibits Caltrans from entering new franchise agreements without legislative approval.<sup>64</sup>

The public has also tended to react negatively to anticompetitive actions, such as traffic calming. In its 2009 comments to proposals to build a new private highway, the City of Golden, Colorado wrote:

The Transportation Commission is being tempted by . . . the suggestion that there is “free” money available from potential investors in the Jefferson Parkway. However, the Study makes clear that the “free” money comes at the very high cost of eliminated highway capacity, increased congestion and degradation of highway safety. . . . The Study’s euphemism of “traffic calming” really means reducing the speeds and capacity on Indiana, a street which drivers have paid for with their tax dollars and currently enjoy today. This forces drivers to choose between paying a toll to go out of their way or be stuck in congestion on the unnecessarily “calmed” rural stretch of Indiana Street.

. . . [D]egraded roadway conditions and increased traffic congestion are] an essential part of the JPPHA’s plan. Without these failing conditions, little traffic would be induced to use the expensive Jefferson Parkway. . . . By starving SH 93 and Arvada roadways of needed improvements, JPPHA would ensure congestion and push some traffic to its road. However, what is good for a road is not good for drivers. The goal of state highway access should be to promote mobility, not to impair mobility to promote the ability to toll a road.

. . . .

This so-called “traffic calming” for Indiana is a transparent euphemism for slowing down traffic to force drivers to use the toll road—a classic congestion guarantee designed to artificially prop up revenue for a private toll road operator. The Institute of Transportation Engineers defines traffic calming as follows: “Traffic calming involves changes in street alignment, installation of barriers, and other physical measures to reduce traffic speeds and/or cut-through volumes, in the interest of street safety, livability, and other public purposes.” Traffic calming usually involves reductions in lane width, speed bumps, introduced curves and other measures to physically slow drivers. . . . [T]here is no transportation justification for such measures on Indiana Street. . . . [T]his comes at a high cost to all of the drivers forced to make a decision between wasted time, wasted gasoline and tolls. . . . This means that drivers will replace

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<sup>64</sup> NCHRP REPORT, *supra* note 61, at 12. The American Trucking Association’s (ATA) list of conditions necessary to protect the public interest includes banning noncompete clauses that forbid improvements on competing highways. *Id.* at 19.

current free and direct routes with costly routes that are likely to take them out of their way and result in the consumption of extra fuel.<sup>65</sup>

Yet despite public unhappiness, infrastructure privatization agreements typically forbid building or improving competing infrastructure<sup>66</sup> in order to leave no alternative to the privatized infrastructure in order to guarantee the contractor's revenues.<sup>67</sup>

Experience with competition between a privatized tollroad (M5) and a public road in Hungary beginning in the mid-1990's provides an example of how competition between a toll and free road commonly play out. Avoidance of M5 eventually led the government to agree to make up the private company's lost revenues.<sup>68</sup> Traffic on the free roads near M5 increased 30% and eventually led the Government to subsidize both local users and the private company.<sup>69</sup> In short, despite coercing drivers to use a private tollroad, efforts to protect the revenues of a private infrastructure contractor have often not succeeded. Ironically, then, privatization, which governments have turned to as a source for financing infrastructure, may actually exacerbate governments' financial woes.

In its 2008 report, the Federal Highway Administration also advocated revenue reimbursements to private contractors as an alternative to or in conjunction with noncompetition agreements.<sup>70</sup> The report explains that if steps are not taken to protect contractors' anticipated revenues, payments to the state will be lower.<sup>71</sup> Strategies of ensuring that governments do not take actions that decrease contractor revenues make it harder for governments to protect the wider public interest. Indeed, government may take actions whose effects include lowering private revenues, but government does not take those actions in order to harm private contractors' revenues. The difficulty is that transportation systems do more than just transport people and goods from point A to point B. They affect air, water, and soil quality; generate noise; and affect communities' quality of life.

In the United States, approximately 28 percent of total greenhouse gas emissions, which have been demonstrated to contribute significantly to global climate change, are attributed to the transportation sector. Private

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<sup>65</sup> Letter from City of Golden to Chairman & Transp. Comm'rs, Transp. Comm'n of Colo., 1, 7, 11 (Jul. 22, 2009).

<sup>66</sup> See U.S. PIRG EDUCATION FUND, PRIVATE ROADS, PUBLIC COSTS: THE FACTS ABOUT TOLL ROAD PRIVATIZATION AND HOW TO PROTECT THE PUBLIC Appendix A (2009), available at <http://www.uspirg.org/uploads/H5/Q1/H5Q10NcoPVeVJwymwlURRw/Private-Roads-Public-Costs.pdf> (providing examples).

<sup>67</sup> Pagano, *supra* note 11, at 373–74.

<sup>68</sup> ÁRPÁD G. SIPOSS, TOLLING ON THE HUNGARIAN MOTORWAY NETWORK 6/14 (2005), available at <http://www.piarc.org/library/aipcr/2/96F0i2jcGYbBqRNJ9VIA3630.pdf>. Other privatized Hungarian roads encountered additional problems. See MICHAEL B. LIKOSKY, LAW, INFRASTRUCTURE, AND HUMAN RIGHTS 147–48 (2006).

<sup>69</sup> World Bank, The Negative Revenue Effects of Parallel Roads in Mexico and Hungary, available at [http://www.worldbank.org/transport/roads/tr\\_docs/annex8.pdf](http://www.worldbank.org/transport/roads/tr_docs/annex8.pdf).

<sup>70</sup> See, e.g., FED. HIGHWAY ADMIN. U.S. DEP'T OF TRANSP., INNOVATION WAVE: AN UPDATE ON THE BURGEONING PRIVATE SECTOR ROLE IN U.S. HIGHWAY AND TRANSIT INFRASTRUCTURE 31, 61 (2008), [http://www.fhwa.dot.gov/reports/pppwave/ppp\\_innovation\\_wave.pdf](http://www.fhwa.dot.gov/reports/pppwave/ppp_innovation_wave.pdf).

<sup>71</sup> *Id.* at 61.

vehicles are now the largest contributor to household ‘carbon footprint[,]’ accounting for 55 percent of carbon emissions from U.S. households.<sup>72</sup>

Thus, for the life of an infrastructure privatization contract, government obligations to insure a contractor’s revenues complicate—and even eliminate—options for addressing challenges, such as reducing air pollution, environmental degradation, and urban and suburban congestion; mitigating greenhouse gases connected with global climate change; promoting public health; and tackling other problems related to car-focused transportation.<sup>73</sup>

Recall that the Northwest Parkway contract imposed a financial penalty for building or improving mass transit.<sup>74</sup> The contracts for Virginia’s Pocahontas Parkway and Chicago parking meters go farther. The Pocahontas Parkway requires that the government “exercise all discretionary authority available to it under Laws, Regulations and Ordinances to prevent any other governmental or private entity from developing Competitive Transportation Facilities, including but not limited to connections to State Highways.”<sup>75</sup> The Chicago Parking Meter Contract requires the city to “use its reasonable efforts to oppose and challenge such action by any such other Governmental Authority; *provided, however*, that all reasonable out-of-pocket costs and expenses incurred by the City in connection with such opposition or challenge shall be borne by the Concessionaire.”<sup>76</sup> In short, this contract requires that government act as an agent or lobbyist for the private contractor—or pay for not making sufficient efforts. Thus, the people’s interests are limited and constrained by those of the private contractor.

The GAO’s March 2009 review of surface transportation recognized government’s struggle to accommodate many competing goals.<sup>77</sup> Infrastructure privatization contract terms that freeze the status quo for generations could leave us with obsolete

<sup>72</sup> STAA BLUEPRINT, *supra* note 12, at 2.

<sup>73</sup> It is ironic, then, that the stated goals of the legislation proposed to permit privatizing Pennsylvania highways were offered as “reasons for privatization . . . promises of ‘abating environmental pollution, advancing energy efficiency and conservation, improving homeland security, increasing capacity . . . and [raising] revenues available for public transportation purposes.’” Pagano, *supra* note 11, at 370–71; see also Steven D. Cook, *Climate Change: 29 Percent of Greenhouse Gas Emissions Come From Transportation, Department Says* 1 (BNA) IIPR 13, Apr. 26, 2010, available at [http://news.bna.com/iiln/IILNWB/split\\_display.adp?fedfid=17012173&vname=iiprbulallissues&fn=17012173&jd=a0c2v3k5a8&split=0](http://news.bna.com/iiln/IILNWB/split_display.adp?fedfid=17012173&vname=iiprbulallissues&fn=17012173&jd=a0c2v3k5a8&split=0).

<sup>74</sup> See *supra* notes 1–10 and accompanying text.

<sup>75</sup> *Agreements: Agreements Review: Pocahontas Parkway*, FED. HIGHWAY ADMIN., <http://www.fhwa.dot.gov/ipd/p3/agreements/pocahontas.htm>. In the 2006 Pocahontas Parkway contract the Virginia Department of Transportation acknowledged that an existing “competitive transportation facility or the expansion of existing transportation facilities” so that they become a competitive transportation facility “may adversely affect Toll Revenues.” Amended and Restated Comprehensive Agreement (Related to the Grant of a Permit) to Develop and Operate the Route 895 Connector, between Virginia Department of Transportation, Commonwealth of Virginia and Transurban (895) LLC, Art. 12.01(a) (June 29, 2006), available at <http://www.virginiadot.org/business/resources/Amended%20and%20Restated%20Comprehensive%20Agreement.pdf>. Therefore, the Virginia DOT will owe compensation for lost revenues if it fails “to exercise discretionary authority . . . available to it under Laws to prevent the development” of a competitive facility. *Id.* at Art. 12.01(a)(iii)–(iv).

<sup>76</sup> CHICAGO PARKING METER CONTRACT, *supra* note 6, § 14.5 (emphasis in original).

<sup>77</sup> U.S. GOV’T ACCOUNTABILITY OFFICE, GAO-08-400, SURFACE TRANSPORTATION: RESTRUCTURED FEDERAL APPROACH NEEDED FOR MORE FOCUSED, PERFORMANCE-BASED, AND SUSTAINABLE PROGRAMS 26–28 (2008), available at <http://www.gao.gov/new.items/d08400.pdf>.

transportation or, at the least, supporting an expensive featherbedding system that unnecessarily delays modernizing transportation. This was the case with Hungary's M-5, because it imposed private and localized impediments to regional planning and integrated transportation systems.<sup>78</sup>

The inclusion of noncompetition and reimbursement terms in privatization agreements alters governance in many ways. First, it creates divided loyalties for public officials. Although public officials sign these agreements in order to serve the public's need and desire for transportation, the officials find themselves compelled to prevent or impede public access to attractive transportation alternatives. It is no wonder that the public has felt betrayed when it has learned of the existence of noncompete agreements.<sup>79</sup>

Second, these agreements constrain options for addressing critical problems and public needs for generations. Across this country, state and local governments are the vehicles by which to provide more urban green space, lower air and soil pollution, walkable cities and to take other actions, such as those set out in PlaNYC's ambitious program.<sup>80</sup> A truck and car-based transportation system that largely depends on oil and gasoline makes the United States dependent on unstable suppliers, many of whom are in conflict zones.<sup>81</sup> A transportation system that was less dependent on petroleum could lessen U.S. entanglement with unseemly actors. Achieving each of these goals requires strategies that include less driving and, thus, less need for highways, parking meters, and parking garages. However, standing in the way of achieving these goals that are vital to our well-being are the costs of reimbursing private contractors for their projected lost revenues.

Third, contracting with a government means having a party with the power to alter conditions that directly affect the value of the contract to the other party. One of the ways government can alter an infrastructure contract's value is to build a competing means of transportation, in the case of a highway, or parking facility, in the case of street parking meters. Refusing to include a noncompetition agreement where the contractor wants one is not an option if private contractors are to be willing to lease public infrastructure.

This conflict could be resolved by accepting that a government may need to be perpetually in breach of an infrastructure privatization contract, and, thus, must buy its way out of obligations throughout the contract's term. The Chicago parking meter contract seems to contemplate exactly that situation in its provisions on "Reserved Powers Adverse Actions."<sup>82</sup> However, rather than being a solution to the problem of rigid contract terms that apply for generations, being in continual breach may be evidence of the inadvisability of agreeing to these contracts. Certainly, to have governments knowingly breach contracts is not good practice. Contract terms that hold back progress, impose extra costs on the public, and even force suboptimal decisions are a high price to

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<sup>78</sup> SIPOSS, *supra* note 68.

<sup>79</sup> Daniel Sorid, *Colorado Highway "Slowdown" Sparks Debate on Toll Roads*, REUTERS, Aug 11, 2005.

<sup>80</sup> PLANYC 2030, <http://www.nyc.gov/html/planyc2030/html/home/home.shtml> (last visited Jan. 26, 2011).

<sup>81</sup> See *Recent Country Analysis Brief Updates*, U.S. ENERGY INFO. ADMIN., <http://www.eia.doe.gov/cabs/newint.html>.

<sup>82</sup> See CHICAGO PARKING METER CONTRACT, *supra* note 6, § 14.3.

pay for financing infrastructure. This is especially true when there are other, better options for raising money.

We seem to have forgotten that federal, state, and local governments have long financed public works and other needs without turning to privatization. The two main options for financing infrastructure have long been taxes and the issuance of bonds, and that is still the case. As of 2008, more than 50,000 state and local entities had issued municipal securities and more than 2 million separate bond issues were outstanding.<sup>83</sup> Indeed, according to the GAO: “A number of alternative financing mechanisms—such as enhanced private-sector participation, bonds, loans, and credit assistance—can be used to help state and local governments finance surface transportation. These financing mechanisms, where appropriate, could help meet growing and costly transportation demands.”<sup>84</sup> In fact, although highway privatization receives a great deal of attention, public money continues to be far more important in providing transportation infrastructure. A 2009 study found that only ten percent of the \$126.6 billion spent on transportation infrastructure in 2007 was provided by private funding.<sup>85</sup> In recent years, however, the federal government promoted highway privatization by creating new financial instruments and creating tax breaks to private contractors to make privatization attractive. The two primary financial subsidies allow contractors to issue tax-free bonds and take highly accelerated depreciation and amortization of costs.

First, the 2005 Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users (SAFETEA-LU) extended the ability to issue tax-exempt bonds from public to private entities that were seeking to fund infrastructure privatization. The new instrument was called “Private Activity Bonds” or PABs. Although SAFETEA-LU limited the total amount of private activity transportation bonds to \$15 billion, the ability to offer investors tax exemptions on their interest made PABs attractive and substantially lowered the cost of raising private capital.<sup>86</sup> At the same time, however, tax-exempt

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<sup>83</sup> Susan Chandler, *What Happens When the City Leases Public Assets to Private Investors? You Pay a Lot More*, CHI. TRIB., Sept. 7, 2008, at C-1, available at [http://articles.chicagotribune.com/2008-09-07/news/0809070213\\_1\\_midway-airport-lease-luggage](http://articles.chicagotribune.com/2008-09-07/news/0809070213_1_midway-airport-lease-luggage).

<sup>84</sup> GAO REPORT HIGHWAY TRUST FUND, GAO-09-845T, *supra* note 17, at 1, 10; see Ellen Dannin & Lee Cokorinos, *Infrastructure Privatization in the United States in the New Millennium*, in THE OXFORD HANDBOOK OF STATE AND LOCAL GOVERNMENT FINANCE (Robert D. Ebel & John E. Petersen eds., 2011), for an overview of the government provisions commonly used in financing highway privatization.

<sup>85</sup> CONG. BUDGET OFFICE & JOINT COMM. ON TAXATION, SUBSIDIZING INFRASTRUCTURE INVESTMENT WITH TAX-PREFERRED BONDS 4 (2009), available at <http://www.cbo.gov/ftpdocs/106xx/doc10667/10-26-TaxPreferredBonds.pdf>.

<sup>86</sup> BENJAMIN G. PEREZ & JAMES W. MARCH, PUBLIC-PRIVATE PARTNERSHIPS AND THE DEVELOPMENT OF TRANSPORT INFRASTRUCTURE: TRENDS ON BOTH SIDES OF THE ATLANTIC, FED. HIGHWAY ADMIN. (2006), available at

[http://financecommission.dot.gov/Documents/Background%20Documents/perez\\_banff\\_ppp\\_final.pdf](http://financecommission.dot.gov/Documents/Background%20Documents/perez_banff_ppp_final.pdf).

Perez and March's paper was presented at the First International Conference on Funding Transportation Infrastructure, Institute of Public Economics at the University of Alberta, Banff Centre, Alberta, Canada. *Id.*; see also JOINT COMM. ON TAXATION, JCX-56-08, OVERVIEW OF SELECTED TAX PROVISIONS RELATING TO THE FINANCING OF SURFACE TRANSPORTATION INFRASTRUCTURE 15–18 (2008), available at <http://www.jct.gov/x-56-08.pdf>; Tony Furst, HOFM Director, Federal Highway Administration, Presentation, Freight Provisions in SAFETEA-LU (Sept. 2005), available at [http://www.fhwa.dot.gov/freightplanning/safetea\\_lu.htm](http://www.fhwa.dot.gov/freightplanning/safetea_lu.htm) (noting that private activity bonds enable loans for these projects at a lower interest as the purchasers of bonds don't have to pay federal taxes on the incomes they receive). Tax-exempt bonds have also been made available to private contractors operating municipal

bonds will lower government revenues and, thus, contribute to government revenue shortfalls and to some degree prompt governments to seek solutions such as privatization.

A second support for infrastructure privatization is provided by tax deductions that allow investors to take deductions for highly accelerated depreciation on infrastructure. It is these tax deductions that drive the multi-decade length of infrastructure privatization contracts. Investors may take those deductions, however, only when they have effective ownership of the property. Effective ownership is demonstrated when the contract term exceeds the useful economic life of the property. In other words, the multi-decade contracts that distort governance exist so that the private contractors can qualify for tax deductions that will attract investors. In fact, to further ensure that the transaction is viewed as transferring effective ownership to the private contractor, sections 2.8 of the Indiana Toll Road and of the proposed 2008 Pennsylvania Turnpike contract say that the parties intend the transaction to be a sale for tax purposes in substantially similar language.

However, it is puzzling that the contract terms far exceed the actual useful life of highways and streets.

The Bureau of Economic Analysis estimates the service life of highways and streets to be 45 years, while the Chicago Skyway and Indiana Toll Road agreements were for terms of 99 and 75 years, respectively. . . . [W]hile the facts and circumstances of each transaction will control its tax treatment, these arrangements will most likely be viewed by the parties as a sale and purchase of a trade or business, and the concession agreement can be expected to include a provision describing the intended tax treatment in this manner.<sup>87</sup>

Senator Jeff Bingaman, correctly characterized these multi-generation contracts as not a lease but as “essentially sell off vital components of the interstate highway system.”<sup>88</sup> It

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water systems. Craig Anthony (Tony) Arnold, *Privatization of Public Water Services: The States' Role in Ensuring Public Accountability*, 32 PEPP. L. REV. 561, 571–72 (2005).

<sup>87</sup> *Tax and Financing Aspects of Highway Public-Private Partnerships: Hearing Before the Subcomm. On Energy, Natural Res. and Infrastructure of the S. Comm. on Finance*, 110th Cong. 5 (2008) (statement of Edward D. Kleinbard, Chief of Staff, Joint Comm. on Taxation), available at <http://finance.senate.gov/imo/media/doc/072408ekttest.pdf>; see also U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-08-1052T, HIGHWAY PUBLIC-PRIVATE PARTNERSHIPS, SECURING POTENTIAL BENEFITS AND PROTECTING THE PUBLIC INTEREST COULD RESULT FROM MORE RIGOROUS UP-FRONT ANALYSIS 7–8 (2008) (JayEtta Z. Hecker, Director Physical Infrastructure Issues, GAO), available at <http://www.gao.gov/new.items/d081052t.pdf> (discussing the financial tradeoffs of privatization); JOINT COMM. ON TAXATION, OVERVIEW OF SELECTED TAX PROVISIONS RELATING TO THE FINANCING OF SURFACE TRANSPORTATION INFRASTRUCTURE, *supra* note 86. The testimony of the other witnesses at that hearing, which was chaired by Senator Jeff Bingaman, is also very useful for understanding highway financing. See *Tax and Financing Aspects of Highway Public-Private Partnerships: Hearing Before the Subcomm. On Energy, Natural Res. and Infrastructure of the S. Comm. on Finance*, 110th Cong. 5 (2008) (statement of Edward D. Kleinbard, Chief of Staff, Joint Comm. on Taxation), available at <http://finance.senate.gov/hearings/hearing/download/?id=8387f870-43c1-48e7-977b-de66a7dbc9f8>.

<sup>88</sup> *Tax and Financing Aspects of Highway Public-Private Partnerships: Hearing Before the Subcomm. On Energy, Natural Res. and Infrastructure of the S. Comm. on Finance*, 110th Cong. 2 (2008) (opening statement of Sen. Jeff Bingaman (D-N.M.), Chairman, Subcomm. on Energy, Natural Res. and

is an open question why the terms are roughly double the time needed to qualify for effective ownership and the deduction.

The goal of that sell off is to entice investors by ensuring that they will make money by being able to claim a full tax deduction for the asset's depreciation within the first fifteen years of the lease agreement. It may be that having lease terms almost double the life of the infrastructure is intended to allow generations of investors to serially take advantage of the deduction. In fact, these deductions have been important incentives to encourage the private sector to invest in infrastructure privatization.<sup>89</sup>

Even the GAO, which has issued many studies of highway finance, was unaware of this tax deduction and of its effects. The GAO learned about the deduction from an official involved in private infrastructure investment:

According to the Chief Executive Officer of the Chicago Skyway, 'concession rights' is treated as an Internal Revenue Code section 197 intangible and is amortized in 15 years, regardless of the lease term or the useful life of the asset. However, costs allocated to "tangible assets" are subject to the normal depreciation rules. This official also told us that about \$1.5 billion of the Chicago Skyway lease amount was for concession rights, and \$334 million was allocated to the tangible asset.<sup>90</sup>

The second financing incentive that attracts investment in infrastructure is tax-free bonds. The amounts involved are not trivial:

The amount of tax-preferred debt issued to finance new infrastructure projects undertaken by the public and private sectors totaled \$1.7 trillion from 1991 to 2007. About three-quarters of those bond proceeds, or roughly \$1.3 trillion, was for capital spending on infrastructure by states and localities, and the remainder was used to fund private capital investment for projects that serve a public purpose, such as schools and hospitals. That \$1.3 trillion amounted to over one-half of the \$2.3 trillion in capital spending on infrastructure by state and local governments (that is, net of federal grants and loan subsidies).<sup>91</sup>

Investors are attracted to tax-free bonds because they will not owe taxes on the interest earned. Tax-free bonds are not cost-free to governments. Whether private or public, their use in financing infrastructure means less tax revenue is collected by the government and available to fund public needs. However, there are important differences in the effects of private versus public tax-free bonds. When government foregoes tax revenue on bonds, it does so to attract investors. As a result, the benefit and burden to government balance out. But this is not the case when government loses tax revenue on

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Infrastructure), available at <http://finance.senate.gov/hearings/hearing/download/?id=8387f870-43c1-48e7-977b-de66a7dbc9f8>.

<sup>89</sup> U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-08-44, HIGHWAY PUBLIC-PRIVATE PARTNERSHIPS: MORE RIGOROUS UP-FRONT ANALYSIS COULD BETTER SECURE POTENTIAL BENEFITS AND PROTECT THE PUBLIC INTEREST 26-27 (2008), available at <http://www.gao.gov/new.items/d0844.pdf>.

<sup>90</sup> *Id.* at 27 n.18.

<sup>91</sup> CONG. BUDGET OFFICE & JOINT COMM. ON TAXATION, *supra* note 85, at vii.

bonds issued by private contractors. In addition to lost revenues, PABs create a competitor to government in the market for tax-free bonds and thus government has more difficulty attracting investors.

Not only does government provide large financial subsidies to private infrastructure investors, it does so at some risk. The Congressional Budget Office and Joint Committee on Taxation warn:

Concerns about economic efficiency are particularly acute for the federal tax preferences that help finance private-sector investment in infrastructure, because those preferences risk transferring resources from taxpayers to private investors without obtaining a commensurate payoff in terms of the value of the infrastructure services that would not have been provided without that subsidy. For example, the fact that those infrastructure facilities are in private hands indicates that owners can capture—through user fees and other charges—a sizable portion of the value of the services they provide. Hence, public benefits from those investments may be small relative to those of infrastructure owned and operated by government, and determining the appropriate degree of subsidy—or whether any is warranted—may be difficult. If the private-sector investment would have taken place even without a subsidy, then the tax preference simply shifts resources from taxpayers to private investors. Because tax preferences for private-sector borrowers lower the cost of financing and hence the return needed to make an investment attractive, they can also reallocate capital from profitable projects to projects that otherwise would not have been undertaken, thereby potentially reducing economic growth.<sup>92</sup>

Noncompete agreements and tax subsidies to induce private investment in infrastructure concessions lead to the perverse result that state and local governments are limited for decades in their ability to provide for the public welfare. They are limited, first, in losing the ability to construct facilities to meet public needs if doing so violates the contract. Second, they lose taxes from investor revenues, which, but for tax deductions to induce investment in privatized infrastructure might have been invested in taxable funds. Third, providing highly accelerated depreciation of infrastructure investments impoverishes the federal government.

*C. Adverse Actions—Contract Provisions That Affect Government Rights to Legislate and Adjudicate*

The “adverse action” provisions of the proposed Pennsylvania Turnpike contract require compensating the private contractor for “enacting any legislation or ordinance or promulgating any rule or regulation” that principally affects the private contractor or private toll road operators or is reasonably expected to have the effect of causing a “material adverse effect on the fair market value” of the infrastructure.<sup>93</sup> The

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<sup>92</sup> *Id.* at 7.

<sup>93</sup> [Proposed] Pennsylvania Turnpike Agreement, § 14.1 89–90 (on file with author).



Commonwealth of Virginia's contract with Transurban of Australia and Fluor Corporation of Texas to build high-occupancy toll lanes on the Capital Beltway requires Virginia to reimburse the private companies whenever carpools exceed twenty four percent of the traffic on the carpool lanes for the next forty years "or until the builders make \$100 million in profits."<sup>94</sup> Since carpools are exempt from tolls, those reimbursements will have to come from the Commonwealth's budget.<sup>95</sup> That situation is not without irony. "The project, in the works for nearly a decade, was planned as a way for private companies to add capacity to one of the most congested roads in the country, with little cost or risk to the public."<sup>96</sup>

The contract for the now bankrupt<sup>97</sup> San Diego South Bay Expressway (SR 125), gives the private contractor the right to compensation if the state legislature, CalTrans, any administrative body, or voters create a law in any form that leads to acquiring part of the road, negatively affects the private contractor's rights, or regulates or interferes with its right to collect tolls. It is also entitled to compensation if any of those results are caused by a court order, decree, or judgment.<sup>98</sup>

The Chicago parking meter contract does not forbid Chicago's enacting laws or taking actions that adversely affect contractor revenues, but it does allow the contractor to charge Chicago for taking actions adverse to the private contractor's receipt of its expected revenues.<sup>99</sup>

Although the existence of adverse action rights and their effects are not widely known by most people in the United States, similar provisions, known as "stabilization clauses," have long existed in contracts between nations and investors in order to protect investors from the risk of nationalization or expropriation.<sup>100</sup> Their purpose evolved to protect international investments from risks associated with changes in laws, including the application of international and domestic human rights and environmental laws. A 2008 research project on stabilization clauses conducted for the International Finance Council and the United Nations Special Representative to the Secretary General on Business and Human Rights found, among other things, that stabilization clauses were

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<sup>94</sup> Amended and Restated Comprehensive Agreement (Related to the Grant of a Permit) to Develop and Operate the Route 895 Connector, between Virginia Department of Transportation, Commonwealth of Virginia and Transurban (895) LLC, *supra* note 75.

<sup>95</sup> Eric M. Weiss, *Toll-Lanes Contract Could Cost State—Deal to Allow Free Carpooling on Beltway Project Might Leave Va. Owing Millions*, WASH. POST, Jul. 20, 2008, at C06, available at <http://www.washingtonpost.com/wp-dyn/content/article/2008/07/19/AR2008071901651.html>; see also Kattula, *supra* note 9; Steve Kattula, *Corporate Welfare and the Beltway HOT Lanes, Part 2: You Better Not Carpool (Too Much)*, GREATER GREATER WASH., Nov. 11, 2009, available at <http://greatergreaterwashington.org/post.cgi?id=4041>.

<sup>96</sup> Weiss, *supra* note 95.

<sup>97</sup> Steve Schmidt, *Toll Road Operator Files for Chapter 11 - South Bay Expressway Use below Forecasts*, SAN DIEGO UNION-TRIB., March 23, 2010, available at <http://www.signonsandiego.com/news/2010/mar/23/south-bay-expressway-builders-file-chapter-11/>.

<sup>98</sup> FED. HIGHWAY ADMIN., AGREEMENT REVIEW: SOUTH BAY EXPRESSWAY (SR 125), Sept. 2005, *infra* Appendix.

<sup>99</sup> See CHICAGO PARKING METER CONTRACT, *supra* note 6, § 14.3.

<sup>100</sup> DOMINIC AYINE, ET AL., INT'L INST. FOR ENV'T AND DEV., LIFTING THE LID ON FOREIGN INVESTMENT CONTRACTS: THE REAL DEAL FOR SUSTAINABLE DEVELOPMENT 4 (2005), available at <http://www.iiied.org/pubs/display.php?o=16007IIED> (follow "Download PDF (free)" hyperlink).

a risk-mitigation tool to protect foreign investments from such sovereign risks as nationalization, expropriation, or the obsolescence bargain, in which the host state can use changes in circumstances to impose new requirements on investors. These clauses also may be designed to insulate investors from environmental and social legislation, a matter of growing economic significance to investors. Lenders often view stabilization clauses as an essential element of the bankability of an investment project, particularly in emerging markets, and they may insist that at least the fiscal terms of an agreement be stabilized. Host states have viewed stabilization clauses as a way to foster a favorable investment climate.<sup>101</sup>

These clauses are particularly attractive when long periods of time are needed to recoup costs and become commercially viable.<sup>102</sup> It is understandable why an entrepreneur, entering into a multi-decade contract with a government, would want to limit the state's power to alter the terms of the agreement or existing opportunities for making a profit by using its powers to legislate or adjudicate. However, stabilization clauses can be and have been used to exempt firms from national and international law, treaties, and standards,<sup>103</sup> allowing private interests to trump public policy.

Critics of international stabilization clauses have advocated the need for protections, including full and meaningful disclosure of stabilization clause terms, before a contract is agreed to<sup>104</sup> and the inclusion of language stating that the private contractors refrain

from seeking or accepting exemptions in the statutory or regulatory framework, including by way of government contracts, related to environmental, health, safety, labour, taxation, financial incentives, or other issues. MNEs [Multinational Enterprises] should refrain from asserting or advancing any claim against a host government or another party with respect to laws, regulations or measures relating to human rights, health, safety or the environment.<sup>105</sup>

Stabilization clauses today take a variety of forms. A United Nations/IFC study of stabilization clauses found clear differences in the degree to which the clauses exempted companies from laws and the type of clause used in Organisation for Economic Co-operation and Development (OECD) countries versus non-OECD countries. Contracts with OECD countries tend to take the view that investors take the risk that laws of

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<sup>101</sup> ANDREA SHEMBERG, STABILIZATION CLAUSES AND HUMAN RIGHTS: A RESEARCH PROJECT CONDUCTED FOR IFC AND THE UNITED NATIONS SPECIAL REPRESENTATIVE TO THE SECRETARY GENERAL ON BUSINESS AND HUMAN RIGHTS vii (2008), *available at* [http://www.ifc.org/ifcext/enviro.nsf/AttachmentsByTitle/p\\_StabilizationClausesandHumanRights/SFILE/Stabilization+Paper.pdf](http://www.ifc.org/ifcext/enviro.nsf/AttachmentsByTitle/p_StabilizationClausesandHumanRights/SFILE/Stabilization+Paper.pdf).

<sup>102</sup> *Id.* at 5.

<sup>103</sup> INT'L BAR ASS'N., WORKING GROUP ON THE OECD GUIDELINES FOR MULTINATIONAL ENTERPRISES, RESPONSE TO THE UK CONSULTATION ON THE TERMS OF REFERENCE FOR AN UPDATE OF THE OECD GUIDELINES FOR MULTINATIONAL ENTERPRISES 33 (2009), [http://oecdwatch.org/publications-en/Publication\\_3290/at\\_download/fullfile](http://oecdwatch.org/publications-en/Publication_3290/at_download/fullfile).

<sup>104</sup> *Id.* at 19.

<sup>105</sup> *Id.* at 33.

general applicability will affect them and that compensation is available only for new laws that have a discriminatory intent and effect as to the investor.<sup>106</sup> “Investors are expected to comply with all new laws, to absorb the costs of compliance with all generally applicable laws. . . [and] to minimize costs arising from complying with changes in law.”<sup>107</sup>

While clauses used in OECD countries either did not exempt companies from laws or had only limited exemptions, stabilization clauses in contracts with non-OECD countries did exempt companies from complying with changes in laws.<sup>108</sup> The non-OECD countries most likely to have the clauses most protective of investor profits and least deferential to the countries’ laws were contracts from Sub-Saharan Africa, the Middle East and North Africa, and Eastern, Southern Europe and Central Asia regions.<sup>109</sup>

There is some irony that a controversial tool now mostly used in developing countries to exempt companies from the application of laws is standard in infrastructure privatization contracts in the United States. But far more important than the insult to our pride or our pocketbooks, these contracts elevate private contractors to a quasi-governmental status, giving them power over new laws, judicial decisions, propositions voted on by the public, and other government actions that a contractor claims will affect toll roads and revenues through the life of the contract.

Agreeing to include an adverse action provision in an infrastructure privatization contract creates fundamental conflicts for governments. Legislative, executive, and judicial bodies are bound to represent the public interest, faithfully execute the laws, and apply and interpret law to adjudicate disputes. However, as with the other contract provisions discussed, infrastructure privatization agreements will alter the roles government entities play in important ways. As discussed above, it is not just the actual payment of compensation that will affect conduct.<sup>110</sup> The mere fear that compensation could be owed or that there could be a legal battle can result in delegating legislative, executive, and judicial powers to a private actor.<sup>111</sup> State and local bodies must act with an eye to the effects their decisions will have—or can be argued to have—on the contractor’s revenues. Thus, by contract they must elevate those private interests above others, public and private.

Seventy years ago, Professor Louis L. Jaffe provided an overview and meditation on the operation and validity of allowing contract terms to oust government.<sup>112</sup> Among the issues Jaffee explored was whether to allow equivalent authority to be exercised by private parties, since the State’s authority is based in the consent of those affected by law.<sup>113</sup> Jaffee also observed that, in many instances, the force of contract had been made equivalent to law and even been allowed to oust government from acting. Meanwhile, government was also required to enforce private terms through criminal and civil

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<sup>106</sup> SHEMBERG, *supra* note 101, at xi.

<sup>107</sup> *Id.* at xi.

<sup>108</sup> *Id.* at ix, 10, 25.

<sup>109</sup> *Id.* at 33.

<sup>110</sup> *See supra* Part. II.A.–B.

<sup>111</sup> *See* Dannin, *supra* note 60, at 130–31, 150–51, for a discussion of the non-delegation doctrine in the context of privatization; *see supra* Part II.A.

<sup>112</sup> Louis L. Jaffee, *Law Making by Private Groups*, 51 HARV. L. REV. 201 (1937).

<sup>113</sup> *Id.* at 208–13.

sanctions.<sup>114</sup> At the same time, this privatized lawmaking was much more difficult to attack than law enacted by governments.<sup>115</sup> Jaffee’s insights from seventy years ago as to the elevated status contract has given private individuals are certainly relevant today. Had the Pennsylvania Turnpike lease been approved, legislation, administration, enforcement, and adjudication of its law would have been altered for over three generations. By the time the contract expired, decisions made and actions taken solely because the contract required them would have permanently altered the state. Meanwhile, we have decades to watch how events unfold in those states and cities that privatized their infrastructure.

### III. THE PUBLIC INTEREST

#### A. *Who Pays, How, and Why?*

For many state and local governments that feel pinched financially, privatization seems to be the only way to provide basic services and infrastructure while not raising taxes. At the September 25, 2010 American Road and Transportation Builders Association conference, aides from both political parties “acknowledged that, by necessity, such public-private deals will play a part in future funding, especially in light of the congressional reluctance to increase the gas tax that is the main source of federal transportation revenue.”<sup>116</sup> Kathy Dedrick, senior director for Barbara Boxer (D-Cal.), Chairman of the Senate Environment and Public Works Committee “said both partnerships and tolling will be one part of many in the Senate bill.”<sup>117</sup>

One government official explained the Commonwealth of Virginia’s decision to enter into a highway privatization agreement this way:

“Is this the ideal way to build public infrastructure? No,” said Gerald E. Connolly (D), chairman of the Fairfax County Board of Supervisors. But he said that voters have turned down tax increases and that the General Assembly has failed to come up with additional money.

“At some point, we have to find a way to fund public infrastructure,” Connolly said.<sup>118</sup>

The consensus seems to be that there are few alternatives to privatization. “For state and municipal governments strapped for cash to complete much-needed infrastructure construction and maintenance, public-private partnerships (P3s)—where

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<sup>114</sup> *Id.* at 217–19.

<sup>115</sup> *Id.* at 216–21.

<sup>116</sup> See Adam Snider, *Transportation: Highway, Transit Policy Bill Could Hamper Private-Sector Investment, Republicans Say*, BNA INFRASTRUCTURE INVESTMENT & POLICY REPORT, Sept. 28, 2009, [http://news.bna.com/iiln/IILNWB/split\\_display.adp?fedfid=15131241&vname=iiprbulallissues&fn=15131241&jd=a0c0p0x6j1&split=0](http://news.bna.com/iiln/IILNWB/split_display.adp?fedfid=15131241&vname=iiprbulallissues&fn=15131241&jd=a0c0p0x6j1&split=0).

<sup>117</sup> *Id.*

<sup>118</sup> Weiss, *supra* note 95.

authorities lease infrastructure assets to private parties, which then operate and design them—are becoming more attractive.”<sup>119</sup>

However, would the states’ residents approve if they knew how much the public invests in these deals? In the case of the Capitol Beltway, less than 20% of the upfront funds came directly from the private investors. The rest was provided from government funds or government subsidies, including low-interest loans, direct subsidies, tax deductions, and other public sources:

Of the total \$1.9 billion (and rising), Fluor-Transurban is contributing only \$349 million in private equity. Meanwhile, the state is paying \$409 million and the Federal Highway Administration is lending Fluor \$585 million in low-interest loans and \$586 million in subsidized bonds. Taxpayers are also on the hook every year for the next 40 years for the carpool fees charged to the state account.<sup>120</sup>

Was it impossible to have gotten a better deal? Was this the only alternative?

Public officials may say that there are no alternatives because of public resistance to taxes. They see privatization as providing improved infrastructure while not raising taxes and as allowing the blame for unpopular decisions, such as imposing or raising tolls or fees, to be shifted to a private contractor. Chicago officials, for example, contended that “it would have been impossible for the City to have both kept the parking-meter system and raised the rates to the same extent as the lease, because there was not sufficient political will to do so . . . .”<sup>121</sup> The Chicago Inspector General found these claims to be untrue in the case of privatizing Chicago’s parking meters;<sup>122</sup> however, a study of Kansas policymakers concluded that the public is unlikely to support tolls to the extent it sees tolls as taxes.<sup>123</sup>

Although opinion on the issue of the public’s acceptance of raising taxes is mixed, the public has loudly opposed increased tolls and fees. That opposition does not mean the public approves of public subsidies to privatize infrastructure. Rather, that acceptance is more likely the result of the public’s lack of information. In any case, fear of citizen resistance to and retaliation for raising taxes is an important factor in decisions to privatize infrastructure.<sup>124</sup> “Given that the option of raising taxes to fund an increasing

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<sup>119</sup> Joshua Hamerman, *More Infrastructure Privatization Coming; Latest Chicago Deal Highlights the Growth of a Developed Market for Infrastructure Privatization in the US*, 74 INV. DEALERS’ DIG. 3 (2008).

<sup>120</sup> Kattula, *supra* note 9 (emphasis in original); see Steve Kattula, *Corporate Welfare and the Beltway HOT Lanes, Part 1: No Free Lunch*, GREATER GREATER WASH., Nov. 9, 2009, <http://greatergreaterwashington.org/post.cgi?id=4011>.

<sup>121</sup> CHICAGO OFFICE OF THE INSPECTOR GEN. REPORT, *supra* note 8, at 4.

<sup>122</sup> *Id.* at 5.

<sup>123</sup> KANSAS POLICYMAKER REPORT, *supra* note 21, at 4-36.

<sup>124</sup> *Anyone for US PPP? Catherine McGuirk talks to US Secretary of Transportation Mary Peters*, PROJECT FINANCE JUNE 2008; Tom Barnes, *Turnpike Lease Looks Good on Paper: Rendell Advisers Present a Study Seeing Potential for Big Profits*, PITT. POST-GAZETTE, May 22, 2007,

<http://www.post-gazette.com/pg/07142/788007-147.stm>; Leslie Wayne, *Politics and the Financial Crisis Slow the Drive to Privatize*, N.Y. TIMES, Jun. 5, 2009, at B-3, available at <http://www.nytimes.com/2009/06/05/business/economy/05private.html>.

number of transportation projects remains politically radioactive, policymakers continue to pursue a range of alternate funding mechanisms and P3s are a critical trend here.”<sup>125</sup>

Public officials need to rethink their duties. They have an obligation to enquire into the extent to which public subsidies fund infrastructure privatization. In addition to knowing the details of infrastructure privatization deals, public officials owe their constituents information, including education about the full effects of infrastructure privatization on public budgets, governance, and democracy. Elliot Sclar refers to the dearth of public information on the consequences of these decisions as “the democracy question”:

The democracy question, or more accurately what I would call the non-democracy question, is central to the creation of P3s. When infrastructure is privatized (or corporatized), the decisions about its size, shape and placement are driven by market demand. The private partners are interested in elements of infrastructure that can yield the longest and strongest streams of privately capturable revenue not the ones that yield the largest public benefits.

. . . Because the interests of the private partners in the placement of infrastructure and their concerns about protecting their revenue streams come to dominate the local discourse the planning approach begins to shift from one in which a comprehensive view of the urban space is replaced by one that views the space as a collection of individual projects that each have to be nurtured separately in terms of the rates of investment return that are pledged to the private owners of the concession for however long the concession lasts.<sup>126</sup>

In states and cities across the country, important factors affecting decisions to privatize are contract terms that allow investors in private sector infrastructure projects to expect fifteen percent returns. Sitting on one side of the table are highly educated and trained analysts with international experience on privatization deals. Sitting across the table are public representatives and administrators who may be involved in negotiating only one such project in their lives and who rely on a staff that is unlikely to have been trained in areas such as specialized tax law and its effects on costs, probability and computer analysis, and mathematical modeling. The Federal Highway Administration would be a logical source for advice, but it has long taken a strong pro-privatization position and not given balanced advice about contract terms or finance.

The recent Michigan House legislative analysis of a bill regulating public-private partnerships relied on an FHWA description of PPPs as eliminating risk: “All PPPs share a common feature: As compared to traditional procurement methods all PPPs transfer risk from the public owner of transportation facility to the contractor.”<sup>127</sup> The current version

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<sup>125</sup> S. Legislative Conference, Public Private Partnerships, Remarks of Sujit M. CanagaRetna before the Idaho Senate Task Force on Treasure Valley Transportation Issues (Dec. 2007), *available at* [http://www.scatlanta.org/Publications/EconDev/2007\\_Idaho\\_speech.shtml](http://www.scatlanta.org/Publications/EconDev/2007_Idaho_speech.shtml).

<sup>126</sup> Sclar Address, *supra* note 63, at 12–13.

<sup>127</sup> TRANSPORTATION—PUBLIC-PRIVATE AGREEMENTS, A SUMMARY OF HOUSE BILL 4961 AS REPORTED FROM COMMITTEE 4-19-10, MICH. H. LEG. ANALYSIS SECTION (2010), <http://www.legislature.mi.gov/documents/2009-2010/billanalysis/House/htm/2009-HLA-4961-3.htm>.

on the FHWA website says: “Toll roads typically use P3s to shift a substantial portion of the risk of meeting these requirements directly to the private sector entity performing the activities and do so in arrangements most able to reduce the risk of non-performance.”<sup>128</sup> The FHWA report Michigan relied upon in drafting its PPP legislation suggests that states will avoid the risks of unforeseen costs if their highways are privatized.<sup>129</sup> The current FHWA statement on risk, though more nuanced, also suggests risks to the public will be substantially reduced if the highways are privatized.<sup>130</sup> Nothing at the FHWA website, however, warns that language commonly found in infrastructure privatization contracts shifts substantial risk—and costs—to the public while also limiting the state and local government’s ability to make policy decisions.

### B. Government Advisors’ Incentives to Recommend Privatization

The pay of those who advise governments about infrastructure privatization decisions are often dependent on consummating a privatization deal. For example, Morgan Stanley’s compensation as an advisor on the Pittsburgh parking garage deal depended on consummating the deal. In the end, it was paid \$3 million from the proceeds of the deal.<sup>131</sup> Morgan Stanley was also paid on a success-fee basis as advisor to Governor Rendell on the Pennsylvania Turnpike deal.<sup>132</sup> When Pennsylvania legislators objected that the payment created an incentive to “recommend the largest transaction possible rather than a course of action which may be more balanced and more prudently serve the needs of the Commonwealth and its residents,” the governor’s budget secretary said that the payment structure did not violate conflict-of-interest law.<sup>133</sup>

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<sup>128</sup> *Innovative Program Delivery: Public Private Partnerships: FAQs*, FED. HIGHWAY ADMIN. [hereinafter FHA FAQs], <http://www.fhwa.dot.gov/ipd/p3/faqs/index.htm>. The FHWA’s publication on international infrastructure privatization provides more discussion of the role of risk. For example, it says, “Long-term risk assumption by the private partner is seen as a driver of innovative project concepts and solutions.” And, “All public agencies visited emphasized effective risk allocation as an important aspect of a PPP project. If significant risks throughout the project’s life cycle are not transferable to the private sector, then the project is likely not an appropriate candidate for delivery via PPP.” FED. HIGHWAY ADMIN., FHWA-PL-09-010, PUBLIC-PRIVATE PARTNERSHIPS FOR HIGHWAY INFRASTRUCTURE: CAPITALIZING ON INTERNATIONAL EXPERIENCE, 21, 25 (2009), [http://international.fhwa.dot.gov/links/pub\\_details.cfm?id=642](http://international.fhwa.dot.gov/links/pub_details.cfm?id=642) (follow “PDF Version” hyperlink).

<sup>129</sup> See FHA FAQs, *supra* note 128; TRANSPORTATION—PUBLIC-PRIVATE AGREEMENTS, A SUMMARY OF HOUSE BILL 4961 AS REPORTED FROM COMMITTEE, *supra* note 127.

<sup>130</sup> See FHA FAQs *supra* note 128; *Innovative Program Delivery: Public Private Partnerships: FAQs*, FED. HIGHWAY ADMIN., <http://www.fhwa.dot.gov/ipd/p3/faqs/index.htm>. The FHWA’s publication on international infrastructure privatization provides more discussion of the role of risk. For example, it says, “Long-term risk assumption by the private partner is seen as a driver of innovative project concepts and solutions.” FED. HIGHWAY ADMIN., FHWA-PL-09-010, PUBLIC-PRIVATE PARTNERSHIPS FOR HIGHWAY INFRASTRUCTURE: CAPITALIZING ON INTERNATIONAL EXPERIENCE, 21, 25 (2009), [http://international.fhwa.dot.gov/links/pub\\_details.cfm?id=642](http://international.fhwa.dot.gov/links/pub_details.cfm?id=642) (follow “PDF Version” hyperlink). And, “All public agencies visited emphasized effective risk allocation as an important aspect of a PPP project. If significant risks throughout the project’s life cycle are not transferable to the private sector, then the project is likely not an appropriate candidate for delivery via PPP.” *Id.*

<sup>131</sup> Adam Brandolph, *2 Law Firms Hired in Pittsburgh Parking Authority Privatization Move*, PITT. TRIB.-REV., Jan. 22, 2010, [http://www.pittsburghlive.com/x/pittsburghtrib/news/pittsburgh/s\\_663520.html](http://www.pittsburghlive.com/x/pittsburghtrib/news/pittsburgh/s_663520.html).

<sup>132</sup> Joe Grata, *\$2.1 Million for Lease Advice Goes to Firm Tied to Rendell*, PITT. POST-GAZETTE, May 15, 2008, <http://www.post-gazette.com/pg/08136/881981-147.stm>.

<sup>133</sup> Paul Nussbaum, *Turnpike Lease Plan Sent to Pa. Legislature: Gov. Rendell’s Proposal to Raise Money for State Transportation Projects Faces Major Opposition*, PHIL. INQUIRER, May 22, 2007,

In addition to avoiding the legislators' concern, the Rendell administration also took the position that success fees were standard in these types of transactions.<sup>134</sup> Using as its standard whether the payment format created a conflict of interest also ignored a higher and different standard—the government's obligation to promote the public interest. And although success fees may be commonly used, prevalence of usage says nothing about whether success fees create inappropriate incentives. The Republican legislators also objected that, in addition to the payment system, "Morgan Stanley could wind up as the investment banker for the project, working for the successful bidder and earning even more money."<sup>135</sup> Although it would not technically be payment for its reaching a deal, being given that position as a result of work on the deal would certainly be a financial reward for Morgan Stanley.

A governor considering privatizing infrastructure certainly needs knowledgeable advisors. If that knowledge is limited only to finance and structuring deals and if that expertise is rewarded only if a deal is consummated, important considerations are left out of the decision-making process. If there is no advisor charged with and rewarded for representing the public interest or with ensuring that full information and points of view be considered, then the decision to privatize is all but inevitable.

Political leaders ignore the public interest at their peril. Reactions discussed throughout this Article have shown that when the citizenry has been kept in the dark and when the public interest has been ignored, people have been deeply indignant. They are likely to be concerned that a fair process be used in making such an important decision. It is possible that people may decide that privatizing public infrastructure is the best alternative for many reasons. They may also decide to reject agreements that put infrastructure, paid for with public funds, under private control. People may also reject contracts that give such strong protection for contractor revenues and place limits on governmental decision making. Without information, however, people cannot meaningfully participate in these important decisions.

### C. *The Infrastructure Privatization Revolving Door*

Consider also the infrastructure contractor / investor / advisor revolving door. Governor Rendell relied on Morgan Stanley and the law firm of Mayer Brown as his advisors during the Pennsylvania Turnpike privatization process.<sup>136</sup> Both were among the forty-eight firms that had originally submitted expressions of interest in making a

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[http://www.philly.com/inquirer/home\\_top\\_stories/20070522\\_Turnpike\\_lease\\_plan\\_sent\\_to\\_Pa\\_legislature.html#ixzz16nAFbuO7](http://www.philly.com/inquirer/home_top_stories/20070522_Turnpike_lease_plan_sent_to_Pa_legislature.html#ixzz16nAFbuO7).

<sup>134</sup> Press Release, Governor Rendell Announces Selection of Financial Adviser for Transportation Funding Options, Morgan Stanley & Co. to Analyze All Options, Including Turnpike's Proposal (Mar. 29, 2007) (on file with author).

<sup>135</sup> Tom Barnes, *Turnpike Lease Looks Good on Paper: Rendell Advisers Present a Study Seeing Potential for Big Profits*, PITT. POST-GAZETTE, May 22, 2007, <http://www.post-gazette.com/pg/07142/788007-147.stm>.

<sup>136</sup> Brian Baxter, *Mayer Brown, Ballard Spahr Advising Pennsylvania on Turnpike Privatization*, AM LAW DAILY, May 19, 2008, <http://amlawdaily.typepad.com/amlawdaily/2008/05/mayer-brown-bal.html>; Joe Grata, *\$2.1 Million for Lease Advice Goes to Firm Tied to Rendell*, PITT. POST-GAZETTE, May 15, 2008, <http://www.post-gazette.com/pg/08136/881981-147.stm>; Paul Nussbaum, *Morgan Stanley Chosen to Advise on Road Leasing*, PHILA. INQUIRER, Mar. 30, 2007.



formal bid on the Turnpike.<sup>137</sup> Both have served as international and domestic advisors to governments, private contractors, and infrastructure investment groups.<sup>138</sup> It makes sense to hire an advisor with experience and expertise in putting together the terms of complex infrastructure deals.

Morgan Stanley, through its various components, certainly has deep expertise related to infrastructure privatization. For example, in October 2006, Morgan Stanley Infrastructure and contractor LAZ were awarded the ninety-nine year lease for Chicago's parking garages. Two years later, in 2008, Morgan Stanley was part of a consortium called Chicago Parking Meters, LLC that leased Chicago's parking meters for 75 years.<sup>139</sup> While advising Governor Rendell on the Pennsylvania Turnpike deal, Morgan Stanley was also amassing over \$4 billion in the Morgan Stanley Infrastructure Partners investment fund.<sup>140</sup> There is no doubt that Morgan Stanley had relevant experience and expertise. The problem is not whether that experience, gained while performing each of these roles provides important insights into deals, but whether those multiple ongoing roles also create actual or potential conflicts of interest.<sup>141</sup> Indeed, at the time the Turnpike deal was pending, people pointed out that Morgan Stanley's various involvements created incentives that undercut its independent judgment and ability to act on behalf of the Commonwealth of Pennsylvania.<sup>142</sup>

Ethical standards, such as those of the American Bar Association, for lawyers and Rule 10(b)(5) of the Securities and Exchange Act,<sup>143</sup> warn against engaging in certain conduct,<sup>144</sup> and these warnings should be respected. Unfortunately, Morgan Stanley's official Code of Ethics and Business Conduct<sup>145</sup> does not address the problem that its multiple roles create. It also does not sufficiently recognize the existence of incentives that could affect its employees' independent judgment when they neither act as advisers to state and local governments nor appreciate the ethical issues they face. The inclusion of many provisions in the proposed Pennsylvania Turnpike contract that are found, often verbatim, in other privatization contracts and that promote the interests of private

<sup>137</sup> Nussbaum, *supra* note 136; Paul Nussbaum, *Pa. Turnpike Lease Plans 'Proprietary'; Penndot Is Keeping 48 Firms' Plans for Running the Toll Road Secret from Legislators Even as the Governor Makes His Pitch*, PHILA. INQUIRER, Mar. 20, 2007, at A01.

<sup>138</sup> MORGAN STANLEY, <http://www.morganstanley.com/index.html> (last visited Sept. 19, 2010) (listing countries which it has advised); *Offices*, MAYER BROWN, <http://www.mayerbrown.com/offices/index.asp> (last visited Nov. 26, 2010) (listing its worldwide offices).

<sup>139</sup> Hamerman, *supra* note 119; Jerry Crimmins, *Privatization Deals May Be Tougher Now; But Are Not Dead; Lawyer Says*, CHI. DAILY L. BULL. 10001, Apr. 21, 2009.

<sup>140</sup> Hamerman, *supra* note 119; Press Release: Morgan Stanley Closes \$4.0 Billion Global Infrastructure Fund (May 12, 2008), <http://www.morganstanley.com/about/press/articles/6330.html>; Kelly Holman, *Infrastructure Investment Speeds Up: Morgan Stanley and Global Infrastructure Partners Are Latest To Raise Investment Vehicles for the Space*, INVESTMENT DEALERS DIG., May 12, 2008, <http://www.iddmagazine.com/news/181743-1.html>.

<sup>141</sup> See ABA MODEL RULES OF PROF'L CONDUCT, R. 1.7–1.9, available at [http://www.abanet.org/cpr/mrpe/mrpe\\_toc.html](http://www.abanet.org/cpr/mrpe/mrpe_toc.html) (concerning the Client-Lawyer Relationship).

<sup>142</sup> *Longterm Lease of Turnpike Likely Best Value for Pennsylvania - Gov Rendell Seeking Law for a Concession*, TOLLROADSNEWS, May 21, 2007, <http://www.tollroadsnews.com/node/145>.

<sup>143</sup> Employment of Manipulative and Deceptive Practices, 17 C.F.R. § 240.10b-5.

<sup>144</sup> See ABA MODEL RULES OF PROF'L CONDUCT, R. 1.7–1.9, available at [http://www.abanet.org/cpr/mrpe/mrpe\\_toc.html](http://www.abanet.org/cpr/mrpe/mrpe_toc.html) (concerning the Client-Lawyer Relationship).

<sup>145</sup> *Morgan Stanley: Code of Ethics and Business Conduct*, MORGAN STANLEY, <http://www.morganstanley.com/company/governance/ethics.html>.

investors at the expense of state and local governments may themselves be evidence of a conflict of interest. It may be that Morgan Stanley advised including noncompete agreements and adverse action terms in the Pennsylvania contract only because it saw them as standard contract terms. It may also have supported their inclusion because it accurately believed that no private contractor would be interested in a deal that did not include them.

The question remains as to the effect of such a deal on the interests of the people of Pennsylvania. Morgan Stanley's many roles—and especially its past and future experience as a contractor and future role as an investor in privatization deals—may also have predisposed it to include contract terms that would benefit investors, advisors, and contractors, all of which it had been, was at the time, and was likely to be in the future. The concern is not just that Morgan Stanley's expertise might have so narrowed its vision that it failed to consider the public interest. It is that an advisor who lacked those ties and incentives could have taken a fresh look at the terms' value to Pennsylvanians' interests and more impartially advised whether they should be included, even though the private contractors who submitted bids insisted upon them.

The Rendell administration's dismissal of the possibility that Morgan Stanley had a conflict of interest seems to have been based on a very narrow understanding of what constitutes a conflict of interest. Roy Kienitz, then deputy chief of staff for Governor Rendell, now Under Secretary of Transportation for Policy in the Obama Administration,<sup>146</sup> said that Morgan Stanley would not be making any decisions with regard to the terms of the Turnpike contract:

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

He said Morgan Stanley are strictly prohibited under the terms of their employment by the state from working for any bidder and from bidding. He said their compensation is proportional to the value of any deal consummated to give them an incentive to work to maximize benefits to the state. If they were paid a fixed fee they wouldn't have that incentive.<sup>147</sup>

The law firm of Mayer Brown was also a consultant on the Pennsylvania Turnpike deal.<sup>148</sup> It has also served as an adviser on other major infrastructure privatization deals to governments (Chicago Midway Airport, Chicago Skyway, Colorado Northwest Parkway, Indiana Toll Road, Pennsylvania Turnpike, Chicago Public Parking System)<sup>149</sup> and to infrastructure investors, such as Macquarie, UBS Global Asset Management, and LS Power, “on the structuring, formation, fundraising and closing of regional and global

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<sup>146</sup> *Head Count: Tracking Obama's Appointments*, WASH. POST, <http://projects.washingtonpost.com/2009/federal-appointments/person/roy-kienitz/> (last visited Jan 26, 2011).

<sup>147</sup> *Longterm Lease of Turnpike Likely Best Value for Pennsylvania - Gov Rendell Seeking Law for a Concession*, *supra* note 142.

<sup>148</sup> Crimmins, *supra* note 139.

<sup>149</sup> *Infrastructure: Experience*, MAYER BROWN, <http://www.mayerbrown.com/infrastructure/index.asp?nid=11539> [hereinafter *Mayer Brown Infrastructure Experience*].

infrastructure funds on behalf of both sponsors and major investors.” In addition, it has served as counsel on infrastructure fund formation projects for major global financial institutions.<sup>150</sup>

Mayer Brown’s advertisements as to its international experience demonstrate just how overmatched local governments can be unless they hire advisers with similar expertise:

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

Mayer Brown has worked on some of the largest and most important infrastructure projects in the world. These include the first US airport and first US toll road privatizations, the \$5.2 billion expansion of the Panama Canal and the award-winning Suzhou Industrial Park water project in China. A thorough understanding of the infrastructure market combined with our substantial track record representing clients in landmark deals makes Mayer Brown the first-choice law firm for the industry’s most significant players.<sup>151</sup>

We are a leading law firm in the United States for the privatization of public assets. We regularly advise on drafting and negotiating concession agreements with detailed capital improvement requirements and operating standards. Clients benefit from the knowledge and experience that we have gained from advising on projects such as the Chicago Skyway, Indiana Toll Road, Chicago Midway Airport, Corredor Sur Toll Road, IIRSA Sur Toll Road and Jorge Chávez International Airport.<sup>152</sup>

According to Mayer Brown, the lease agreement it worked on in its role as co-counsel for the State of Indiana on the Indiana Toll Road “followed in many respects the form we developed for the Chicago Skyway transaction” where Mayer Brown acted an adviser to the government.<sup>153</sup>

Revolving door relationships are not unique to the firms involved in the Pennsylvania Turnpike. In the case of the Chicago parking meters, the city’s financial advisers “were working on other multibillion-dollar deals with the company that emerged as the winning bidder, Morgan Stanley. The overlapping relationships [were] in violation

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<sup>150</sup> *Infrastructure: Infrastructure Funds*, MAYER BROWN, <http://www.mayerbrown.com/infrastructure/index.asp?nid=11440> (last visited Sept. 19, 2010).

<sup>151</sup> *Infrastructure*, MAYER BROWN, <http://www.mayerbrown.com/infrastructure/> (last visited Sept. 19, 2010).

<sup>152</sup> MAYER BROWN FACT SHEET, *supra* note 51.

<sup>153</sup> *Mayer Brown Infrastructure Experience*, *supra* note 149.

of the city's own contracting rules."<sup>154</sup> The advisers in these cases were paid based on a percentage of the closing value of the deal. As discussed above, this compensation scheme may have created significant financial incentives to put closing the deal and dollars ahead of other elements of the public interest.<sup>155</sup>

Conflicts of interest exist even among those who provide information that is included in bids. For example, a 2006 *Denver Post* investigation found that only three companies do most of the revenue projections, most of which fail to meet those projections.<sup>156</sup> They also have an interest in seeing the roads they assess be built or that they are later awarded additional work on those roads.<sup>157</sup> According to Robert Bain, an analyst for Standard & Poor's and expert on international toll roads, "[q]uite often, people shop around until they find the people who provide the numbers."<sup>158</sup> Consultants on traffic studies have even been promised lucrative jobs or contracts if a road was built.<sup>159</sup>

It should come as no surprise then that a 2006 *Denver Post* review of twenty-three new U.S. turnpikes nationwide found that a clear majority failed to meet the revenue projections used to justify the costs of building them. Eighty-six percent of new toll roads in eight states "failed to meet expectations in their first full year" and by their third year "75 percent—15 of the 20 that have been open that long—remained poor performers."<sup>160</sup> When there are incentives to inflate factors underlying projections, the figures for actual use were off by "34.5 percent to 67.5 percent of their estimated traffic in their first year of operation" and remained dramatically off in their third year.<sup>161</sup> In August 2010, Australia was rocked with similar revelations that, some said, endangered the future of public-private infrastructure.<sup>162</sup>

Unfortunately, those who are most in a position to understand these contracts have not been fully candid in their public statements about the allocation of risk. Many of those involved in the infrastructure privatization industry claim that most of the risk related to the infrastructure is shifted to the investors. For example, the head of the North American infrastructure finance and advisory business at the Royal Bank of Scotland said, "[u]ltimately, if people don't want to park in downtown Chicago, the risk doesn't accrue to the city, it accrues to the investors," thus "[t]he investors accrue most of the risk

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<sup>154</sup> Ben Joravsky & Mick Dumke, *FAIL: Part III: The Insiders: Who Benefited from the Parking Meter Fiasco*, CHI. READER, June 18, 2009, <http://www.chicagoreader.com/chicago/the-parking-meter-fiasco-part-iii/Content?oid=1127436>.

<sup>155</sup> *Id.*; see *supra* Part III.B.

<sup>156</sup> Chuck Plunkett, *Roads to Riches: Paved with Bad Projections*, DENVER POST, May 28, 2006, [http://www.denverpost.com/news/ci\\_3871773](http://www.denverpost.com/news/ci_3871773).

<sup>157</sup> *Id.*

<sup>158</sup> *Id.*

<sup>159</sup> Chuck Plunkett, *No 2-way Street: When Landowners Help Pay the Toll*, DENVER POST, May 29, 2006, [http://www.denverpost.com/news/ci\\_3876477](http://www.denverpost.com/news/ci_3876477).

<sup>160</sup> *Id.*

<sup>161</sup> *Id.*

<sup>162</sup> Stuart Wilson, *Clem7 Motorway Investors Did Not Get the Whole Picture*, THE AUSTRALIAN, Sept. 7, 2010, <http://www.theaustralian.com.au/business/opinion/clem7-motorway-investors-did-not-get-the-whole-picture/story-e6frg9q6-1225915021261>; Annabel Hepworth & Jared Owens, *Clem7 Tunnel Losses Endanger Public-Private Infrastructure*, THE AUSTRALIAN, Sept. 1, 2010, <http://www.theaustralian.com.au/news/nation/clem7-tunnel-losses-endanger-public-private-infrastructure/story-e6frg6nf-1225912550578>.

and pay the lessor an upfront payment to assume that risk.”<sup>163</sup> It is interesting that people with substantial international experience would counsel their clients to pay huge sums of money merely to assume risk. Obviously, the money is not paid to assume risk but, rather, to generate a return for investors. At best, that claim ignores the risk taken on by the public along with the loss of control over vital assets paid for by public funds. At worst, it hides the risks imposed on the public by these deals.

#### IV. DISCUSSION

Our decision-making processes and ways of thinking about privatization and infrastructure are proving unequal to the complexity and long-term effects of transferring public infrastructure to private hands. It is urgent that we change the terms of this discussion quickly, before contracts have locked away so much of our infrastructure that we have can no longer make critically important policy decisions outside the straitjacket contract terms impose on our legislative, executive, and judicial branches of government. We must, therefore, replace our constricted focus on “dollars and driving, public versus private” with appropriate substantive and procedural principles and processes in order to achieve our articulated goals.<sup>164</sup>

Issues that have emerged as important to this discussion include (1) protecting the public welfare; (2) ensuring value for money; (3) taking all contingencies into account; (4) establishing principles to justify the inclusion of each contract term; (5) demonstrating the superiority of privatization over public provision; and (6) establishing a process that ensures all relevant information is presented and properly evaluated. Each of these principles is easy to articulate and should have broad—but not unanimous—support. The difficulty will be in unpacking their content and identifying the contentious issues each presents. Achieving those goals requires a participatory and open-ended process, one that extends into the future. What can be done here is to lay the groundwork by briefly articulating issues related to each of these principles, examining pending proposals concerning infrastructure privatization, and, finally, considering whether those proposals provide a satisfactory way to deal with the complex issues that lie at the intersection of public and private provision of infrastructure.

##### *A. New Terms for Decisions on Infrastructure Provision*

###### 1. Protecting the Public Welfare

The GAO has warned that the public interest is likely to be overlooked when infrastructure privatization processes fail to formally include the public in the decision-making process.<sup>165</sup> If there is any issue not captured by our impoverished “dollars and

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<sup>163</sup> Hamerman, *supra* note 119.

<sup>164</sup> See Pagano, *supra* note 11, at 368 (noting that a concern about privatization is the public’s inability to obtain information regarding the proposals and to comment); see also Dannin, *supra* note 60, at 111.

<sup>165</sup> Two recent GAO reports focus on this issue and explore it at length. U.S. GOV’T ACCOUNTABILITY OFFICE, GAO-08-1149R, HIGHWAY PUBLIC-PRIVATE PARTNERSHIPS: MORE RIGOROUS UP-FRONT ANALYSIS COULD BETTER SECURE POTENTIAL BENEFITS AND PROTECT THE PUBLIC INTEREST (2008), available at [www.gao.gov/new.items/d081149r.pdf](http://www.gao.gov/new.items/d081149r.pdf); U.S. GOV’T ACCOUNTABILITY OFFICE, GAO-08-44, HIGHWAY PUBLIC-PRIVATE PARTNERSHIPS: MORE RIGOROUS UP-FRONT ANALYSIS COULD BETTER SECURE

driving, public versus private” discussion on infrastructure, it is certainly the public welfare. Public welfare involves far more than a contract’s financial terms, although money certainly matters. A focus on the public welfare raises questions such as what happens when citizens “go from being taxpayers using public facilities to customers of a for-profit business”?<sup>166</sup> Even though that articulation of the issue is more limited than one shaped by a focus on the public welfare, it is far broader than the current constrained discussion.

We cannot broaden our analyses until we identify all elements of the public interest and welfare, and not just smooth roadbeds and uncongested roads that get people from point A to B rapidly. Achieving such a system must provide efficient travel at low financial cost for the greatest number of people. It must also promote clean air and other environmental and health issues. In addition, it needs to do more than merely take into account and anticipate changes in housing patterns, urban density, business locations, and growth; it must promote healthier patterns for going about our daily activities.

A road is of little use if it is not part of a system. Indeed, centuries ago this country moved from having a haphazard assemblage of private roads to our current integrated system of roads, because we were a people with important destinations. We are now a people who need a system that includes more than just roads. To be of any value, the discussion about that system must include all forms of transportation, its location, and what it carries, rather than being limited to just roads, a single road, or even a few miles of a road. While the discussion must have national scope because all transportation decisions have national effects, it must also protect local interests and needs.

Officers of private companies have fiduciary obligations to act on behalf of shareholders by generating profits. If we are to protect the public interest, we need someone charged with fiduciary obligations to the public. Those public protections might be modeled on those of a company’s investors, including disclosure of information sufficient to make an informed decision. To be effective that means highlighting risks of complex financial instruments, fee structures, and potential conflicts of interests.<sup>167</sup> That body must also be charged with resolving the dilemma created by extant—and, most likely, future—infrastructure privatization contracts that protect expected revenues by imposing extra costs on the public.

## 2. Ensuring Value for Money

Protecting the public welfare does not mean excluding economic considerations or the importance of getting value from our assets. One irony of the limited financial focus of current infrastructure privatization analyses is that it can—and has—led to greater collective costs while also overlooking what we truly value. In economic terms,

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POTENTIAL BENEFITS AND PROTECT THE PUBLIC INTEREST (2008), *available at* <http://www.gao.gov/new.items/d0844.pdf>. The City of Chicago Office of the Inspector General also released a report that explored this issue. CHICAGO OFFICE OF THE INSPECTOR GEN. REPORT, *supra* note 8, at 33.

<sup>166</sup> Chandler, *supra* note 83.

<sup>167</sup> AUSTL. SEC. & INVS. COMM’N, CONSULTATION PAPER 134, INFRASTRUCTURE ENTITIES: IMPROVING DISCLOSURE FOR RETAIL INVESTORS 5–6 (2010), *available at* [http://www.asic.gov.au/asic/pdfflib.nsf/LookupByFileName/cp134.pdf/\\$file/cp134.pdf](http://www.asic.gov.au/asic/pdfflib.nsf/LookupByFileName/cp134.pdf/$file/cp134.pdf).

privatized infrastructure makes money through negative externalities, that is, by allowing private contractors to impose costs elsewhere. Those negative externalities can only be identified and avoided by engaging in an extensive discussion about what we mean by “value” and even what is defined as valued. Not all things of value can be easily expressed in monetary terms, making it difficult to ensure they are taken into account. This problem must be addressed.

It should be obvious that unless we identify actual costs and benefits we cannot engage in a cost-benefit analysis; however, governments across the United States are considering whether to sign multi-decade infrastructure privatization contracts without taking either of these necessary steps. As long as state and local governments’ “decisions regarding PPPs are principally based on financial analyses, such as asset valuation,” they miss larger costs.<sup>168</sup> Worse than just failing to identify all costs and benefits, key contract terms have been kept from the public—and not explained—even though it is the public who will be bound by those contractual obligations. If we are to protect the public interest, contracts must be structured so that benefits to the public are commensurate with the length of the contract. Only in this way can we ensure that “upfront” money is not “burned through” within the first years of a lease.<sup>169</sup>

Questions are already being asked about the factors driving governments to enter into contracts that tend to range from fifty to ninety-nine years:

State Senator Jeffrey Schoenberg (D-Evanston), who has studied the proposed privatization of the Illinois Tollway, believes public officials are being outnegotiated and leasing too cheap.

Ninety-nine years is too long for a public asset to be leased, Schoenberg argues, because no one can see that far into the future. Few leases in Europe, for instance, run more than forty years. He also thinks there should be formulas that allow taxpayers to benefit from the upside if deals pay off more handsomely than expected. Spain and others have insisted on such clauses in some of their asset leases.

In the Skyway deal, investors “covered their investment in a few years,” Schoenberg said. “Therefore, everything else was gravy.”<sup>170</sup>

Certainly, the public needs to know about the existence of and cost to the public of tax breaks to private contractors, contractors’ ability to issue tax-free bonds, and the effects of using of tax-free bonds compared with funding from other sources, including understanding how the resulting loss of tax revenue exacerbates the financial woes that make privatization attractive. As part of a comprehensive analysis, we need to examine whether the loss of tax revenue to federal, state, or local budgets caused by tax breaks given to infrastructure privatization investors is a net cost or benefit, because, for example, it attracts private investment. That inquiry must also include a comparison with

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<sup>168</sup> David W. Gaffey, *Outsourcing Infrastructure: Expanding the Use of Public-Private Partnerships in the United States*, 39 PUB. CONT. L.J. 351, 356 n.28, 359–60 (2010).

<sup>169</sup> Nathan Hellman, *Chicago Burning Through Privatization Cash: Think Tank Director Points to Indiana’s Use of Toll Road Cash as a Better Model*, MEDILL NEWS SERVICE NWI.COM, Mar. 1, 2010, <http://www.nwitimes.com/news/local/illinois/0a7f7fef-102b-5ef0-bf76-c0fb5c46e654.html>.

<sup>170</sup> Chandler, *supra* note 83.

the costs and benefits of using public bonds to fund construction and improvements.<sup>171</sup> We need to ask whether it is certain that contractors will refuse to enter into these deals without tax breaks, noncompete agreements, and the like. If tax breaks are a deal breaker, it means that the contractors have concluded that they cannot make a sufficient return on their investments without tax breaks. If that is the case, the information suggests that the private sector is not delivering a superior product through better organization or smarter work processes.

### 3. Taking all Contingencies into Account

Entering into a multi-decade relationship, especially one that is expensive to exit and affects the public interest, requires being a pessimist. Infrastructure privatization deals are vetted by experts who are narrowly focused on making deals happen. People with that point of view—and especially those whose job and pay depend on getting a deal done—have an incentive to be optimistic and to reach a specific result. They lack the necessary pessimism and objectivity required to identify problems. Relationships created by infrastructure contracts involve parties whose interests are not fully aligned. They also have the potential to co-opt public officials. These and other negative outcomes and their effects must be identified and taken seriously while a deal is being considered. The contracts must be examined to ensure that, throughout the contract term, the parties do not undermine one another. The current recession has demonstrated the need to take into account the potential effects of severe economic downturns and disruption, rather than assuming normal to booming economic conditions. For example:

PPPs are vulnerable to both the financial and the real impact of the crisis. Although the final consequences and duration of the crisis are not yet known, the likely effects on PPPs can already be identified. Both existing and planned (hereafter pipeline) PPP programs could be affected through various channels, such as the availability and cost of credit, lower growth, and unforeseen exchange rate movements. Depending on the contractual arrangement between the parties, the changed distribution of risks can shift the cost burden between the parties, weakening the attractiveness of PPPs.<sup>172</sup>

At the least, there must not be incentives for analyses to reach a specific result, nor disincentives to giving honest, negative assessments.<sup>173</sup>

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<sup>171</sup> An article by Susan Chandler identifies a number of issues related to infrastructure privatization. See Chandler, *supra* note 83. These should be part of the process advocated here.

<sup>172</sup> Philippe Burger, et al., *The Effects of the Financial Crisis on Public-Private Partnerships* 3 (Int'l Monetary Fund, Working Paper WP/09/144, 2009), available at <http://www.imf.org/external/pubs/ft/wp/2009/wp09144.pdf>.

<sup>173</sup> For example, Pittsburgh “hired global management firm Morgan Stanley to assist in the effort [to lease its parking garages]. *Morgan Stanley will be paid \$3 million from the proceeds of the deal should one be reached.*” Brandolph, *supra* note 131 (emphasis added).



#### 4. Justifying the Inclusion of Each Term in the Contract

Form contracts and the inclusion of standardized clauses in contracts may appear to be a useful way of not reinventing the wheel; however, contract law scholars have identified many concerns about their use, including allowing a sophisticated party to take advantage of an inexperienced party.<sup>174</sup> In addition to the sorts of problematic clauses discussed throughout this Article,<sup>175</sup> it is important to consider the extent to which a contract eliminates accountability mechanisms, including market accountability, and thus is devoid of incentives to modernize and improve.

It is worth considering whether advisers and others, in an abundance of caution, are simply reusing contracts that have so far created no problems without analyzing whether they fit new situations. We know that noncompetition, adverse action, and other provisions are included so that the private contractor can make as much money as possible from the deal, but we do not know whether these deals undermine our commitment to competition and freedom of the market. We also do not know whether very long contract terms eliminate the market discipline that would exist if the state could take its business elsewhere when a contractor's performance is poor.

#### 5. Demonstrating the Superiority of Private over Public Provision

Although the process generally used to decide whether to lease public infrastructure to a private contractor has been negotiation, there are several reasons why negotiation is not an appropriate way to decide whether to privatize infrastructure. First, as discussed earlier, the process of negotiation has focused narrowly on dollars and the details of maintaining and improving the infrastructure.<sup>176</sup> As a result, public interest issues of autonomy and control have been neglected. This is the case even though public officials who participate in the negotiations or decision are charged with representing the public interest.

Second, decisions as to whether infrastructure should be privatized depend on accurately predicting complex events stretching into the distant future. Even basic issues, such as predicting levels of traffic, modes of transportation, and the value of money fifty to ninety-nine years from now present challenges beyond the capacity of principled negotiation. When the foundational premises for making decisions are this imperfect and when obligations are frozen for half a century or more, the effects of imperfections are likely to be magnified. Worse, when the foundations for the contract are fundamentally flawed, even the most rational and principled process of negotiation cannot repair the situation.

If these problems are to be addressed, ascertaining the accuracy of the data relied on is of critical importance. Fortunately, we do have long experience with a process that has operated reasonably well to ascertain the truth in complex, contested situations: trials. It is helpful, then, to consider whether mechanisms used as part of the fact-finding

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<sup>174</sup> David Gilo & Ariel Porat, *The Hidden Roles of Boilerplate and Standard-form Contracts: Strategic Imposition of Transaction Costs, Segmentation of Consumers, and Anticompetitive Effects*, 104 MICH. L. REV. 983 (2006) (presenting and critiquing concern connected to the use of boilerplate).

<sup>175</sup> See *supra* Part III.

<sup>176</sup> See *supra* Part I.

process in trials could play a useful role in making decisions about infrastructure privatization.

In trials in our common law system, the focus is on determining as accurately as possible what happened.<sup>177</sup> Decisions about privatizing infrastructure need to be focused on determining as accurately as possible what *will* happen. In both cases, it is necessary that an assertion be properly established by evidence before it is accepted.<sup>178</sup> The legal system has developed methods for resolving issues related to future conduct, most commonly seen with injunctions.<sup>179</sup> Injunctions are part of a system known as equity, a superstructure built on the common law system, and is not discussed as a model here, though it may provide useful insights into issues related to privatization.

Under the common law, juries and judges regularly make decisions based on their assessment of the credibility of evidence presented to them.<sup>180</sup> They are assisted in that process by a system that depends on adversaries challenging the evidence presented in order to show its flaws, a subject discussed in the next section.<sup>181</sup> One feature that assists the factfinder is the burden of proof. When the factfinder concludes that evidence for and against a result is of equal merit, the party with the burden of proof loses.<sup>182</sup> The placement of burdens of proof—in particular two of its components, the burdens of production of evidence and persuasion of the factfinder—have long been found to be a useful truth-seeking mechanism. As Professor Martinez explains:

The burden of proof thus provides the parties to a controversy the necessary structure and guidance to pursue a claim. This responsibility of proof may well act to impose a very real risk of loss on a particular party. Indeed, a certain amount of risk-bearing and risk-shifting may be reasonably required of any moderately sophisticated and efficient dispute resolution system.<sup>183</sup>

Thus, all parties to a controversy are likely to find that burdens provide them with structure and guidance in pursuing and deciding the merits of a claim.

Two rationales for assigning burdens of production and persuasion to a party are especially relevant here: burdens of proof are assigned to the party that (1) alleges the least likely scenario and (2) has the best knowledge about a matter at issue or the easiest

<sup>177</sup> See JACK H. FRIEDENTHAL, ET AL., *CIVIL PROCEDURE* 494–99 (3d. ed. 1999).

<sup>178</sup> See Bert Black & David E. Lilienfeld, *Epidemiologic Proof in Toxic Tort Litigation*, 52 *FORDHAM L. REV.* 732, 764 n.132 (1984) (discussing the similarity between civil procedure and the scientific method in determining what “really” occurred).

<sup>179</sup> See FLEMING JAMES, ET AL., *CIVIL PROCEDURE* 31 (5th ed. 2001).

<sup>180</sup> Harry Kalven and Hans Zeisel’s 1966 study, *The American Jury*, found that trial judges in the criminal cases studied agreed with juries in at least a quarter of the cases. HARRY KALVEN & HANS ZEISEL, *THE AMERICAN JURY* (1966). A more recent effort to replicate that study found similar results. Theodore Eisenberg, et al., *Judge-Jury Agreement in Criminal Cases: A Partial Replication of Kalven and Zeisel’s The American Jury*, 2 *J. EMPIRICAL LEGAL STUD.* 171 (2005).

<sup>181</sup> See *infra* Part IV.A.6.

<sup>182</sup> See JAMES *supra* note 179, at 414–23.

<sup>183</sup> Leo P. Martinez, *Tax Collection and Populist Rhetoric: Shifting the Burden of Proof in Tax Cases*, 39 *HASTINGS L.J.* 239, 246 (1988) (footnotes omitted); see Charles V. Laughlin, *In Support of the Thayer Theory of Presumptions*, 52 *MICH. L. REV.* 195, 219 (1953) (identifying several reasons for the existence of presumptions); J.P. McBaine, *Burden of Proof: Degrees of Belief*, 32 *CAL. L. REV.* 242, 261 (1944) (discussing a sample jury instruction for a finding by the preponderance of evidence).

access to evidence.<sup>184</sup> The two burdens work together and are conceptually linked. “[A] decision as to whether a party has satisfied the production burden cannot be made without considering the degree of certainty required to meet the persuasion burden.”<sup>185</sup>

In making decisions about infrastructure privatization, it is proponents of privatization who allege the least likely scenario: that public infrastructure is better provided by private parties. That conclusion is based on the United States’ history and experience of many services and goods having been first provided by private entities and then moved into the public sector as a result of problems with private provision.<sup>186</sup> It is therefore useful to respect the meaning of that placement in deciding whether to change the provision of infrastructure from the public to the private sector. The burden of persuasion should, therefore, be assigned to the party asserting that specific infrastructure should be privatized.<sup>187</sup>

As discussed earlier, it is the proponents of privatization who have particular knowledge about the matters at issue or who have the easiest access to that information.<sup>188</sup> Therefore, the burden of production of evidence should be placed on them. An additional reason for that placement of the burdens of production and persuasion is to account for (1) costs associated with the disruption associated with change and (2) the problem of identifying and accurately valuing all costs. It is prudent, for both these reasons, to require that there have been an honest and complete examination of the existing situation compared with the proposed alternative and whether the status quo can be improved by less drastic changes.<sup>189</sup>

The evidence to be presented and examined will generally include identifying the basic responsibilities in terms of services and how they are provided. Whether services or functions are currently delivered in an efficient cost-effective fashion must be considered, and if they are not delivered in a cost-effective manner, evidence must be presented as to how their performance could be improved with or without privatization. To those factors should be added the record of analogous contracting situations with full explanations for differences in performance between the public sector and private contractors, if such differences exist. The decision-making process should also take into account hidden or external costs associated with privatization to avoid contracting out when it does not actually provide superior outcomes.<sup>190</sup> That includes examining ways to

<sup>184</sup> Martinez, *supra* note 183, at 252–54.

<sup>185</sup> Black & Lilienfeld, *supra* note 178, at 764 n.131.

<sup>186</sup> See Moshe Adler, *The Origins of Governmental Production: Cleaning the Streets of New York By Contract During the 19th Century*, available at [http://archive.epinet.org/real\\_media/010111/materials/adler.pdf](http://archive.epinet.org/real_media/010111/materials/adler.pdf); see also Ellen Dannin, *To Market, To Market: Caveat Emptor*, *TO MARKET, TO MARKET: REINVENTING INDIANAPOLIS* 8–10 (Sheila S. Kennedy et al. eds., 2000).

<sup>187</sup> See ROBERT GINSBURG & KEN BLUM, THE MIDWEST CENTER FOR LABOR RESEARCH, ANALYSIS OF PROPOSED PRIVATIZATION OF CHICAGO DEPARTMENT OF STREETS AND SANITATION (DSS) ABANDONED CAR TOWING SERVICES 3–4 (1997), available at <http://inthepublicinterest.org/article/analysis-proposed-privatization-chicago-department-streets-and-sanitation-dss> (follow “Towing Privatization study 1997.pdf” hyperlink).

<sup>188</sup> See *supra* Part III.C.

<sup>189</sup> See Ellen Dannin, *Counting What Matters: Privatization, People with Disabilities, and the Cost of Low-Wage Work*, 92 MINN. L. REV. 1348 (2008), for a discussion of costs commonly overlooked and, therefore, omitted from a privatization analysis.

<sup>190</sup> Some laws have required that a margin of savings be demonstrated. Dannin, *supra* note 186, at 22.

enhance existing management and operations and considering whether the analysis has taken into account that governmental responsibility cannot be limited to delivering services only when they are “profitable.”

#### 6. Establishing a Process that Ensures All Relevant Information is Presented and Properly Evaluated

It is at this point that the process most often breaks down. First, in the case of privatization—in all its forms—all costs are not identified and, therefore, that information cannot be considered in assessing bids. A common example is including the costs of oversight to ensure the private contractor provides the services it agreed to. If costs are not even identified as costs, they obviously cannot be included. In some cases no efforts are made to identify costs, and, in the case of oversight costs, their various forms may be distributed among many parts of government<sup>191</sup> and, thus, difficult to identify.

Second, it is not enough to provide figures to decision makers if they lack the ability to understand them and their significance. Therefore, what is needed is an expert body to evaluate the content of bids<sup>192</sup> and the conclusions to be drawn about them.<sup>193</sup> That expert oversight body must also assist officials in understanding the information provided.<sup>194</sup> Similar challenges exist in trials. One solution has been to use testimony by experts to help a jury understand how to evaluate the evidence.<sup>195</sup> Other options include using blue ribbon juries whose jurors have higher than normal education<sup>196</sup> or skills than the general population or assign fact-finding to special masters.<sup>197</sup>

Third, the thorny problems that exist in deciding whether to privatize do not end when a contract is awarded. Compliance with the terms must be ensured throughout the contract. In testimony before the General Accounting Office, Moshe Adler described provisions advocated by privatization proponents in order to ensure accountability and best value:

Economists today believe that the necessary and sufficient measures for making contracting out competitive are:

- i. Use competitive bidding;
- ii. Divide the service area into different districts;

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The federal government has required that a private-sector bid must demonstrate that privatizing a governmental function will result in “costs savings of 10 percent of personnel-related costs or \$10 million, whichever is less, before awarding the private sector an activity with more than 10 FTEs.” U.S. GOV’T ACCOUNTABILITY OFFICE, GAO-07-434R, IMPLEMENTATION OF OMB CIRCULAR NO. A-76 AT SCIENCE AGENCIES 14 (2007), available at <http://www.gao.gov/new.items/d07434r.pdf>.

<sup>191</sup> Dannin, *supra* note 186, at 15–30, 45–47.

<sup>192</sup> See Patricia Williams, *The Obliging Shell: An Informal Essay on Formal Equal Opportunity*, 87 MICH. L. REV. 2128, 2131–32 (1989) (discussing whether sausage made from sawdust and rat parts is still sausage because it has come through the sausage machine and whatever comes out of that machine is, by definition, sausage).

<sup>193</sup> Dannin, *supra* note 186, at 40–44.

<sup>194</sup> *Id.* at 46–47.

<sup>195</sup> EDWARD W. CLEARY, ET AL., MCCORMICK ON EVIDENCE 33–45 (3d. ed 1984).

<sup>196</sup> Editorial Board, *The “Blue Ribbon” Jury*, 60 HARV. L. REV. 613 (1947) (providing a history of the use of blue-ribbon juries).

<sup>197</sup> See Fed. R. Civ. P. 53.

- iii. The city should perform the service in one of the districts in order to maintain its capacity to replace a delinquent contractor;
- iv. Require performance bonds;
- v. Use short contract periods;
- vi. Contracts should not be renewed without new competitive bids.<sup>198</sup>

In addition, it is argued that the fear of losing a contract to another bidder at the end of the contract term creates competition and market discipline.<sup>199</sup> Whether that is true or not, the multi-generational length of infrastructure contracts effectively removes the lash of nonrenewal after a contract expires. The only option governments have to enforce accountability is strong, ongoing oversight. However, although contracts permit oversight, as discussed earlier, private contractors' right to claim compensation on the grounds that the oversight improperly interfered with the flow of traffic means the right is somewhat constrained.<sup>200</sup>

However effective those solutions seem, it is unlikely they can be applied in the case of infrastructure privatization. One could ask for traffic predictions, and the industry would do a masterful job of producing a persuasive document with figures to support their contentions. However, as with all figures produced by those who are self-interested, their recommendations and reports are not likely to emerge from a process of self-criticism.

Experience with toll road revenue projections are a good example of the problem. Revenue projections are an important factor in contract prices and, potentially, claims for revenues lost as a result of adverse actions. It is, therefore, important that those projections be as accurate as possible, despite being based on estimates about future transportation patterns, the cost of money, the economy, and incentives by others to take

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<sup>198</sup> Moshe Adler, *Why Do We Have Government Employees?*, Senior Economist, Fiscal Policy Inst. & Adjunct Professor, Columbia Univ., Dep't of Urban Planning, Prepared Statement for General Accounting Office Commercial Activities Panel (June 11, 2001); see Moshe Adler, *Been There, Done That! The Privatization of Street Cleaning In Nineteenth Century New York*, NEW LAB. F. 88, 90–81 (Spring/Summer 1999) (providing more details on managed competition). However, close examination of the details of the operation of contemporary privatization and managed competition provides a more complex picture that undermines the view of privatization advocates. See Mildred Warner & Amir Hefetz, *Pragmatism Over Politics: Alternative Service Delivery in Local Government, 1992–2002*, 71 THE MUN. Y.B. 8, 14 (2004).; Roland Zullo, *Confronting the Wicked Witch and Exposing the Wizard Public-Sector Unions and Privatization Policy*, 6 J. LAB. & SOC'Y 9 (2002); Roland Zullo, *In Search of the Silver Lining: The Privatization of Welfare-to-Work Services in San Diego County* (June 21, 200) (unpublished paper) (on file with author).

<sup>199</sup> Dru Stevenson, *Privatization of Welfare Services: Delegation by Commercial Contract*, 45 ARIZ. L. REV. 83, 129 (2003) (“Shorter contracts create higher transaction costs, but foster healthy competition and accountability, as private contractors know their contract is up for renewal before long.”); see also Edward Rubin, *Book Review: The Possibilities and Limitations of Privatization*, 123 HARV. L. REV. 890, 898 (2010) (reviewing GOVERNMENT BY CONTRACT: OUTSOURCING AND AMERICAN DEMOCRACY (Jody Freeman & Martha Minow eds. 2009)) (“[T]here is also a serious constraint on the effectiveness of subsequent monitoring because the government cannot afford to terminate the contract.”); Jon D. Michaels, *Privatization's Pretensions*, 77 U. CHI. L. REV. 717, 743–44 (2010) (“[T]ermination clauses raise the price of the contract, particularly with respect to contracts for complex services . . . that require substantial initial investments of resources, training, and capital outlays . . . [and] may undermine any chance of cost savings to the government.”).

<sup>200</sup> See *supra* Part II.A.

actions adverse to the parties' interests.<sup>201</sup> At the same time, those who are charged with making a decision on behalf of the public lack the capacity to evaluate the evidence presented on traffic predictions and revenue projections. They must, therefore, rely on industry insiders to provide an honestly critical evaluation.

Even imposing high burdens of proof or presumptions against privatization cannot overcome these problems. There must be a body with the expertise to assess data and conclusions. What is needed is something like the Congressional Budget Office,<sup>202</sup> that is, a body staffed with people who have the legal responsibility to critically analyze information plus knowledge and skills that at least match those who are providing expert information concerning privatization.

Other countries have taken that approach and have developed special governmental bodies charged with the obligation to oversee privatization. Spain, for example,

requires the Ministry of Public Works to assign public engineers to oversee performance of PPP projects both during construction and throughout operation. These monitors catalog incidents of noncompliance with the terms of the contract by the private contractor and review and catalog user complaints in an effort to ensure the reliability of the infrastructure and conformance with the concession terms.<sup>203</sup>

The United Kingdom has created a number of permanent governmental and quasi-governmental bodies to handle issues related to privatization. The private finance initiative (PFI) was created in 1992, and, more recently, Partnerships UK, the National Audit Office (NAO), the Public Accounts Committee, and the Audit Commission have been charged with addressing needs not met by the PFI.<sup>204</sup> Other agencies include Infrastructure UK (IUK),<sup>205</sup> the Centre for the Protection of National Infrastructure (CPNI),<sup>206</sup> and the Infrastructure Planning Commission.<sup>207</sup>

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<sup>201</sup> Judy MacInnes, *Cintra's August Traffic Falls on Main Concessions*, REUTERS, Sept. 11, 2008, available at <http://uk.reuters.com/article/rbssIndustryMaterialsUtilitiesNews/idUKLB70560420080911> (noting that the economic downturn has decreed the amount of traffic on the Indiana toll road).

<sup>202</sup> See *Fact Sheet*, CONG. BUDGET OFFICE, <http://www.cbo.gov/aboutcbo/factsheet.cfm>.

<sup>203</sup> Gaffey, *supra* note 168, at 363 (footnotes omitted).

<sup>204</sup> *Id.* at 361–62.

<sup>205</sup> *Infrastructure UK*, HM TREASURY, [http://www.hm-treasury.gov.uk/ppp\\_infrastructureuk.htm](http://www.hm-treasury.gov.uk/ppp_infrastructureuk.htm). It “advises government on the long-term infrastructure needs of the UK and provides commercial expertise to support major projects and programmes.” *Id.* (last visited Nov. 11, 2010).

<sup>206</sup> CENTRE FOR THE PROTECTION OF NATIONAL INFRASTRUCTURE, <http://www.cpni.gov.uk/> (last visited Nov. 11, 2010). The CPNI is the “government authority that provides protective security advice to the national infrastructure.” *Id.*

<sup>207</sup> *Our Role*, INFRASTRUCTURE PLANNING COMMISSION, <http://infrastructure.independent.gov.uk/who-we-are/our-role/>. The IPC is an independent body. INFRASTRUCTURE PLANNING COMMISSION, <http://infrastructure.independent.gov.uk/> (last visited Jan. 26, 2011). It decides “applications for nationally significant infrastructure projects. These are the large projects that support the economy and vital public services, including railways, large wind farms, power stations, reservoirs, harbours, airports and sewage treatment works.” *Id.* After the 2010 elections, the new coalition government announced plans to abolish the IPC, and place its functions elsewhere. *Infrastructure Planning Commission: Planning Reform Following the 2010 General Election*, CAMPAIGN TO PROTECT RURAL ENG., <http://www.planninghelp.org.uk/planning-system/planning-for-major-infrastructure-projects/major-infrastructure-the-infrastructure-planning-commission>. The Government must legislate to abolish the IPC, which it is expected to do in the Decentralisation and Localism Bill due to receive its first reading in

In addition, the UK Treasury issues standardized contract terms accompanied by explanations as to their significance. According to the Treasury:

Sec.1.2.1. The three main objectives of the guidance remain unchanged. First, to promote a common understanding of the main risks which are encountered in a standard PFI project; secondly, to allow consistency of approach and pricing across a range of similar projects; and thirdly, to reduce the time and costs of negotiation by enabling all parties concerned to agree a range of areas that can follow a standard approach without extended negotiations.<sup>208</sup>

In addition to providing these structures and guidance, infrastructure privatization contracts, particularly in Europe, tend to be far shorter than those in the United States. Shorter contracts lessen a whole host of problems, including accuracy of predictions, impingement on democratic processes, and locked-in, obsolescent infrastructure.

### *B. A Way Forward*

In the United States, we are a long way from having a system akin to that which regulates infrastructure privatization in the United Kingdom. Making wise decisions on infrastructure require more than creating an expert decision-making body. Better decisions are most likely to emerge when the public has at least basic knowledge about the terms on which public infrastructure is provided and the effects of the options offered. However, gaining access to information held by private companies, along with other accountability obligations imposed on private actors, present special challenges.<sup>209</sup> Accountability obligations might be imposed on private infrastructure contractors by contract, as long as the contractors were willing to agree to those terms. Legislation might also be enacted to prohibit state and local governments from entering into any contract that does not include public accountability. That legislation could apply at least to components of our interstate highway system or even to all infrastructure built with federal money and that is part of our interstate transportation system. The specific policies for that legislation can be found in the formal name of our interstate system: the Dwight D. Eisenhower National System of Interstate and Defense Highways. That name recognizes the relationship of our system of highways to the public interest.

We currently have a model for, at least, ensuring that important information, relevant to infrastructure privatization, is provided through language proposed in the 111th Congress' House Committee on Transportation and Infrastructure's bill, *The*

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Parliament in November 2010. *Id.* The Government intends to replace the IPC with a Major Infrastructure Planning Unit that would be part of the Planning Inspectorate. *Id.* This Unit would carry out broadly the same functions as the IPC, but final decisions would be made by Ministers based on the recommendations of the Unit. *Id.*; *Planning Act Blog 185: First Hint Of Localism Bill Contents In Regional Strategy Judgment*, MONDAQ BUSINESS BRIEFING, Nov. 11, 2010. However, as of this writing, those anticipated changes have not yet taken place.

<sup>208</sup> HM TREASURY, STANDARDISATION OF PFI CONTRACTS, Version 4 1 (2007), available at [http://www.hm-treasury.gov.uk/d/pfi\\_sopc4pu101\\_210307.pdf](http://www.hm-treasury.gov.uk/d/pfi_sopc4pu101_210307.pdf).

<sup>209</sup> See Dannin, *supra* note 60, for more discussion on these special challenges and related issues.

*Surface Transportation Authorization Act of 2009*<sup>210</sup> and the Committee's accompanying document, *The Surface Transportation Authorization Act of 2009: A Blueprint for Investment and Reform*. That bill emphasizes disclosure, fair process, and attention to the public interest in relation to PPP agreements, and the *Blueprint* succinctly explains the bill's goals.<sup>211</sup>

In addition to new procedures and substantive obligations, the bill proposes creating a new public body charged with implementing new rights and thus potentially moving the United States closer to models found in Europe. The bill itself is infused with decades of experience under the Administrative Procedure Act. Thus, if enacted, these provisions should promote democratic values and build on experience with how complex decisions can be fairly, effectively, and wisely made. The bill recognizes the current system's benefits, such as generating revenues to support transportation projects that might otherwise not be financially viable and problems, such as imposing costs on those least able to pay.<sup>212</sup> It concludes that in order to "protect the integrity of the nation's surface transportation system and the public interest regarding trade and travel, the Federal surface transportation program requires strengthened public protections regarding highway toll projects and PPP agreements."<sup>213</sup> The bill follows up on these findings by including both substantive and procedural protections and positive and negative obligations to deal with common problems that have arisen under current infrastructure privatization agreements, several of which are discussed in the next sections.

### 1. New Substantive Rights

The bill tackles some of the contract terms that have received the strongest criticism. It prohibits noncompete agreements by barring any state or local public authority from entering into an agreement with a private person "under which the State is prevented from improving or expanding the capacity of public roads in the same travel corridor."<sup>214</sup> Those prohibitions are also included in the section of the bill that creates the Office of Public Benefit.<sup>215</sup>

In addition to prohibiting noncompetition agreements and other anticompetitive provisions, the bill mandates that certain terms be included in public-private partnership agreements. Terms that must be included are those (1) that prohibit closing all or part of the highway to vehicular traffic, except "for routine and capital maintenance or accident

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<sup>210</sup> STAFF OF H. COMM. ON TRANSP. & INFRASTRUCTURE, 111TH CONG., SURFACE TRANSPORTATION AUTHORIZATION ACT OF 2009 (Comm. Print 2009). The Surface Transportation Authorization Act of 2009 has not been enacted.

<sup>211</sup> STAA BLUEPRINT, *supra* note 12.

<sup>212</sup> *Id.* at 31.

<sup>213</sup> *Id.*

<sup>214</sup> STAFF OF H. COMM. ON TRANSP. & INFRASTRUCTURE, 111TH CONG., SURFACE TRANSPORTATION AUTHORIZATION ACT OF 2009 § 1301(a). Section 1301(a) would amend § 129(a)(3). *Id.* In addition, if the bill were enacted § 1504 *Public-Private Partnership Agreements* would add § (h) *Public-Private Partnership Agreements* and provide in § 112(h)(3)(B): The contract "does not include any provision under which the State is prevented from improving or expanding the capacity of public roads in the same travel corridor as the highway facility." *Id.* § 1204.

<sup>215</sup> Section 1204 establishes an Office of Public Benefit. *Id.* § 1204. Its duties include vetting the terms of public-private agreements. *Id.* Among the terms it must include ensuring that a PPP agreement "does not include any provision under which the State is prevented from improving or expanding the capacity of public roads in the same travel corridor as the highway facility." *Id.*



clearance”; (2) that give the state or local public authority the right “to enter and take control of the highway facility and reopen it for operation in cases in which the private partner closes the highway facility in violation” of these provisions; (3) that, in the case of evacuations required during a state of emergency involving a major disaster as defined by law, the highway facility must be open and no tolls charged during the evacuation; (4) that the state or local public authority may reclaim ownership of the highway facility during the contract term and must “provide fair market value compensation to the private partner”; and (5) that, when the contract is returned to the public authority at the end of the contract, the road must be or be brought up to “an appropriate state of repair, given its life expectancy.”<sup>216</sup> Finally, contractors are not allowed to compete by underpaying workers.<sup>217</sup> They must pay construction workers “wages at rates not less than those prevailing on projects of a character similar in the locality.”<sup>218</sup>

In short, these new substantive provisions, if enacted, would address strong and persistent criticisms of infrastructure privatization.

## 2. New Procedural Rights

The bill includes new procedural rights designed to bring enhanced information into the decision-making process. In some cases infrastructure has been privatized without providing information to the public, public notice of terms, and an opportunity for public comment, or only minimal time has been provided.<sup>219</sup>

First, the bill mandates that, before the Secretary of Transportation can approve any contract that involves a public-private partnership agreement, the state or local public authority must engage in a “value-for-money assessment” as to whether “a public-private partnership agreement, as proposed for the potential project, would provide value compared with traditional public delivery methods.” That assessment must examine (1) the “potential life-cycle cost and delivery timeframe of the project under traditional public delivery methods as compared to under the approach proposed by the private partner”; (2) benefits or costs associated with any transfer of risk to the private partner under the public-private partnership agreement; and (3) other quantitative and qualitative benefits or costs associated with public delivery of the project.<sup>220</sup> While these are important steps, their efficacy depends upon cash-strapped state and local governments employing people whose interests are not aligned with those of the privatization industry and, yet, have the ability to make those assessments. It may be that only the federal government has the resources to provide that unbiased oversight.

Second, the state or local public authority must make key terms of any proposed public-private partnership agreement available to the public. The bill also addresses contractor concerns by excluding from disclosure “any information in a project proposal

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<sup>216</sup> *Id.* § 1504.

<sup>217</sup> *See id.* § 1505.

<sup>218</sup> *Id.*

<sup>219</sup> *See, e.g.*, Letter from City of Golden to Chairman & Transp. Comm’rs, Transp. Comm’n of Colo., *supra* note 65, at 2–3 (noting that three days notice provided and incomplete information given); CHICAGO OFFICE OF THE INSPECTOR GEN. REPORT, *supra* note 8, at 6 (noting that two days notice was given to the Chicago City Council).

<sup>220</sup> STAFF OF H. COMM. ON TRANSP. & INFRASTRUCTURE, 111TH CONG., SURFACE TRANSPORTATION AUTHORIZATION ACT OF 2009 § 1504 (Comm. Print 2009).

that is, in the judgment of the public authority, confidential or proprietary.”<sup>221</sup> Again, this is a valuable proposal but one that is likely to flounder when it meets strong opposition to disclosure and claims that most contractor information is confidential or proprietary.

Third, the state or local public authority must “offer interested parties a reasonable opportunity to comment on the proposed agreement.”<sup>222</sup> In order to make the right to comment useful, the bill provides that “the public authority shall, to the maximum extent practicable” hold “public meetings at convenient and accessible locations and times” and provide relevant information “in electronically accessible format and means, such as the World Wide Web[.]”<sup>223</sup> To make these disclosures and comment rights meaningful, they must be preceded and accompanied by a widely disseminated educational program that addresses the broad gaps in knowledge that now exist.

### 3. A New Public Rights Protector

Finally, the draft Surface Transportation Authorization Act of 2009 does not leave monitoring and contesting actions solely in private hands. Rather, it establishes an “Office of Public Benefit” as part of the Federal Highway Administration and charges it with providing “for the protection of the public interest in relation to highway toll projects and public-private partnership agreements on Federal-aid highways.”<sup>224</sup> The Office of Public Benefit would be responsible for monitoring and reporting to the Secretary of Transportation, in order to ensure that public authorities meet their legal obligations and to protect the public’s rights set out in the bill.<sup>225</sup>

Under the Act, the Director of the Office of Public Benefit must review and approve or disapprove proposed toll rate schedules and monitor restrictions on use of toll revenues and prohibitions on noncompete agreements.<sup>226</sup> The Director must fully protect the public’s right to comment on toll rate schedules and must ameliorate the effects of tolls on interstate commerce or travel, with special consideration taken for low-income travelers.<sup>227</sup> Finally, the Director must assess whether a proposed public-private partnership agreement “provides value compared with traditional public delivery methods; make[s] available to the public key terms of the contract to be awarded; and offer[s] interested parties a reasonable opportunity to comment on the proposed agreement.”<sup>228</sup>

These three categories of new rights and obligations represent a sea change from recent policy. Only a few years ago, the U.S. Department of Transportation urged states to enact legislation that included, among other things, the power to establish geographic noncompetition zones in order for states to undertake public-private investment

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<sup>221</sup> *Id.*

<sup>222</sup> *Id.*

<sup>223</sup> *Id.* § 1504.

<sup>224</sup> *Id.* § 1204.

<sup>225</sup> *Id.*

<sup>226</sup> *Id.*

<sup>227</sup> STAA BLUEPRINT, *supra* note 12, at 31–32.

<sup>228</sup> STAFF OF H. COMM. ON TRANSP. & INFRASTRUCTURE, 111TH CONG., SURFACE TRANSPORTATION AUTHORIZATION ACT OF 2009 § 1504 (Comm. Print 2009).

initiatives.<sup>229</sup> Recent experiences and public reactions have increased support for outlawing noncompete agreements.<sup>230</sup>

#### 4. The Bill's Future

There is much to like about this bill and its efforts on behalf of investment and reform of our national transportation system. It provides a serious approach to many problems connected with surface transportation, including environmental issues and the need to develop alternative forms of transportation.<sup>231</sup> Unfortunately, it was not taken up in the last Congress, apparently caught up in the need to focus on other issues, such as the economic recovery, financial reform, and health care. Its current prospects seem dismal.

While delay in such an important area is frustrating, it may provide an opportunity to rethink issues. Among other things, the passage of time may make it possible for Congress to consider the novel ideas and perspectives presented in the discussion in Part III.A.

### V. TAXING QUESTIONS

Although the proposed Surface Transportation Authorization Act of 2009 would address important problems, the nation's mood, the economy, and the balance of power in Washington after the 2010 elections mean it is unlikely to become law. As a result, long-pending problems will remain unaddressed. Yet, it is worth noting that the genesis of our interstate highway system was more than seventy years ago during the Great Depression. In February 1938, President Franklin D. Roosevelt asked the U.S. Bureau of Public Roads (BPR) for a feasibility study of a system of transcontinental highways.<sup>232</sup> Congress followed up with two reports: *Toll Roads and Free Roads* (1939) and *Interregional Highways* (1944).<sup>233</sup> The reports recommended "a 'system of direct interregional highways, with all necessary connections through and around cities, designed to meet the requirements of the national defense in time of war and the needs of a growing peacetime traffic of longer range.'"<sup>234</sup>

It is difficult to call to mind the optimism that our forebears had while in the midst of terrible economic troubles and fighting a war in Europe and the Pacific. When the interstate highway system was in its infancy, this was an optimistic country that relished challenges and took on the responsibilities citizens owe their countries and their compatriots. Perhaps those days will never come again. For decades, we have shirked our responsibilities. Indeed, government investment in non-defense infrastructure as a percentage of GDP has declined by more than 40% since 1960, while the U.S. population

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<sup>229</sup> DOT REPORT, *supra* note 61.

<sup>230</sup> See *infra* Part II.B, for a discussion on recent experiences with noncompetition agreements.

<sup>231</sup> STAFF OF H. COMM. ON TRANSP. & INFRASTRUCTURE, 111TH CONG., SURFACE TRANSPORTATION AUTHORIZATION ACT OF 2009 § 701.

<sup>232</sup> Richard F. Weingroff, *Essential to the National Interest*, 69 PUBLIC ROADS, Mar./April 2006, at 2, available at <http://www.ibrc.fhwa.dot.gov/publications/publicroads/06mar/07.cfm>.

<sup>233</sup> *Id.*

<sup>234</sup> *Id.*

has grown by 66%.<sup>235</sup> We are now a country that sells off its assets rather than face up to challenges and responsibilities. But debt and decline are not inevitable, and we can make other, better choices. For example, we can tap sources of revenue that would actually create a fairer tax system. Changes to income tax law since 1995 have let the wealthiest among us pay a decreasing percentage of their income as taxes. As a result, in 2007, the most recent year for which we have information, the top 400 tax filers paid on average \$46 million less in taxes than if they were taxed at 1995 rates.<sup>236</sup> Payments into Social Security stop once a person's income reaches \$106,800.<sup>237</sup> The result is a regressive tax that falls more heavily on those who earn least while also generating less money to fund public needs.

Declining tax rates on top earners has had a profound effect on tax revenues. The Center for Budget and Policy Priorities estimates that, had the top-earning 400 households paid taxes at the rates in effect before those tax cuts, the federal government would have collected an additional \$18 billion each year.<sup>238</sup> Greater tax revenues could then be used to restore our infrastructure, as well as fund other important priorities. In other words, our only option is not selling off our assets on terms that cede to private hands control of our democratic institutions, autonomy, and destiny.

The federal gas tax, which funds our transportation infrastructure, suffers from similar problems. It no longer meets our needs because (1) the increased use of fuel efficient vehicles has driven down fuel tax revenues per mile driven; (2) the tax, long stuck at 18.4 cents per gallon, is not indexed for inflation and has not been raised for over a decade;<sup>239</sup> and (3) there is no political will to take the obvious step of setting the fuel tax at a level sufficient to maintain and build our country's infrastructure. Instead, the federal government has met the revenue shortfall by taking money from other funds.<sup>240</sup> Thus, "what drivers may not see or understand is that even though higher fuel prices mean that they are paying a higher price for driving that *does not mean that they contribute more towards the cost of roads.*"<sup>241</sup> These funding problems and other challenges have kept surface transportation programs on the GAO's High-Risk list.<sup>242</sup>

<sup>235</sup> *Tax and Financing Aspects of Highway Public-Private Partnerships: Hearing Before the Subcomm. on Energy, Natural Res. and Infrastructure of the S. Comm. on Finance, 110th Cong. 2 (2008)* (statement of Pat Choate, Director of Manufacturing Policy Project), available at <http://finance.senate.gov/imo/media/doc/072408pctest1.pdf>.

<sup>236</sup> Avi Feller & Chuck Marr, *Tax Rate for Richest 400 Taxpayers Plummeted in Recent Decades, Even as Their Pre-tax Incomes Skyrocketed*, CENTER ON BUDGET & POLICY PRIORITIES, Feb. 23, 2010, at 1, available at <http://www.cbpp.org/cms/index.cfm?fa=view&id=3090>.

<sup>237</sup> SOC. SEC. ADMIN., UPDATE 2010, available at <http://www.ssa.gov/pubs/10003.pdf>.

<sup>238</sup> See Feller & Marr, *supra* note 236, at 1.

<sup>239</sup> Pagano, *supra* note 11, at 358. Fuel taxes vary among the states. See ENERGY INFO. ADMIN., U.S. DEP'T OF ENERGY, NO. DOE/EIA 0380, PETROLEUM MARKETING MONTHLY, 153 tbl.EN1 (2010), available at [http://www.eia.gov/pub/oil\\_gas/petroleum/data\\_publications/petroleum\\_marketing\\_monthly/historical/2010/2010\\_05/pdf/pmmall.pdf](http://www.eia.gov/pub/oil_gas/petroleum/data_publications/petroleum_marketing_monthly/historical/2010/2010_05/pdf/pmmall.pdf); WILLIAM J. MALLET, CONG. RESEARCH SERV., RL34567, PUBLIC-PRIVATE PARTNERSHIPS IN HIGHWAY AND TRANSIT INFRASTRUCTURE PROVISION 4 (2008), available at <http://openers.com/document/RL34567/2008-07-09/> (follow "Open CRS (user submitted)" hyperlink).

<sup>240</sup> U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-10-780, HIGHWAY TRUST FUND: NEARLY ALL STATES RECEIVED MORE FUNDING THAN THEY CONTRIBUTED IN HIGHWAY TAXES SINCE 2005 21 (2010), available at [www.gao.gov/new.items/d10780.pdf](http://www.gao.gov/new.items/d10780.pdf) [hereinafter GAO HIGHWAY TRUST FUND REPORT, GAO-10-780].

<sup>241</sup> KANSAS POLICYMAKER REPORT, *supra* note 21, at 2–11 (emphasis in original).

<sup>242</sup> GAO Highway Trust Fund Report, GAO-10-780, *supra* note 240, at 21; see also U.S. Gov't Accountability Office, GAO-11-358T, Airport and Airway Trust Fund: Declining Balance Raises Concerns

The obvious fix is to raise the gas tax. It costs little to collect, especially compared to tolls, because it is collected at the point of sale and requires no special collection equipment. The gas tax also fits with the currently popular user-pays philosophy.<sup>243</sup> Unlike tolls, the fuel tax applies to every mile we drive, although greater use of hybrid and electric cars are altering this connection.

However, the fuel tax suffers from the same problem that afflicts all taxes in the United States these days: there are strong objections to paying taxes<sup>244</sup> and, in particular to raising taxes during a recession.<sup>245</sup> These issues were discussed at the dawn of the interstate highway system. “As Congress searched for an alternative financing plan in 1955, the highway-related interests that supported the Interstate System agreed on only one thing—they did not want to pay for it. Why, they asked, should only users pay for a highway network that would benefit the entire country?”<sup>246</sup> We must, once more, consider whether a gas tax is a fair allocation of financial burdens.<sup>247</sup>

In fact, we toll roads to raise revenues to build and maintain roads, but tolls also create disincentives to using the road. Thus tolling can enhance mobility by reducing congestion and the demand for roads when tolls vary according to congestion. Tolls that create incentives for drivers to avoid driving alone in congested conditions may encourage drivers to share rides, use public transportation, travel at less congested times, or travel on less congested routes, if available.<sup>248</sup>

We need to take a frank look at our transportation reality. First, everyone benefits, directly or indirectly, from our system of roads.<sup>249</sup> We all—and drivers in particular—collectively benefit from travel by people who never set tire on a road. Travel by walking, mass transit, or telecommuting make our roads less crowded, slow damage to the roadbed, and give us less polluted air and water. The Department of Transportation’s recently released tools to promote sustainable highways supports this way of viewing our infrastructure:

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over Ability to Meet Future Demands (2011), *available at* <http://www.gao.gov/new.items/d11358t.pdf> (providing overview of the decline in air transportation funding).

<sup>243</sup> The user-pays philosophy is that those who use a good should be the ones who pay for it. Examples of user-pays funding in the case of highways are tolls and the fuel tax. See *Tollroads: Their Past & Their Future*, TOLLROAD NEWS, <http://www.tollroadsnews.com/background>, for a discussion on user-pays. That view is actually quite narrow and ignores the flow-on effects of tolls and the fuel tax. Although those payments are made directly by individuals, the use of the infrastructure benefits the public broadly and the cost of its use is spread through society, for example, by business tax deductions or by purchasing goods that have been transported via the infrastructure.

<sup>244</sup> See Josh Mitchell, *Chamber of Commerce Pushes Increase in Gas Tax*, WALL ST. J., July 15, 2009, *available at* <http://online.wsj.com/article/SB124769092956347439.html>.

<sup>245</sup> See *id.*

<sup>246</sup> Weingroff, *supra* note 234, at 4.

<sup>247</sup> TRANSP. REVIEW BD. OF THE NAT’L ACADS., CRITICAL ISSUES IN TRANSPORTATION 2009 UPDATE 6 (2009), *available at* <http://onlinepubs.trb.org/Onlinepubs/general/CriticalIssues09.pdf>.

<sup>248</sup> See KANSAS POLICYMAKER REPORT, *supra* note 21, at 3–5.

<sup>249</sup> See AM. PUB. TRANSP. ASS’N, PUBLIC TRANSPORTATION: BENEFITS FOR THE 21ST CENTURY (2007), *available at* [http://www.apta.com/resources/reportsandpublications/Documents/twenty\\_first\\_century.pdf](http://www.apta.com/resources/reportsandpublications/Documents/twenty_first_century.pdf); see also ROBERT J. SHAPIRO & KEVIN A. HASSETT, AM. PUB. TRANSP. ASS’N, HEALTHY RETURNS: THE ECONOMIC IMPACT OF PUBLIC INVESTMENT IN SURFACE TRANSPORTATION (2005), *available at* [http://www.publictransportation.org/pdf/reports/healthy\\_returns.pdf](http://www.publictransportation.org/pdf/reports/healthy_returns.pdf).

Viewing highways in isolation is not ideal when addressing sustainability. Sustainability in highways should be addressed with the mindset that highways are one part of transportation infrastructure, and transportation is one aspect of meeting human needs. In addition to addressing environmental and natural resource needs, the development of sustainable highways should include focus on access (not just mobility), moving people and goods (not just vehicles), and providing people with transportation choices, such as safe and comfortable routes for walking, cycling, and transit.<sup>250</sup>

Meanwhile, our primary east-west and north-south roads I-80<sup>251</sup> and I-81 have become increasingly dangerous because of their heavy use.<sup>252</sup> A November 2010 study of Texas road conditions found that poor quality roads cost \$22.6 billion a year “in the form of traffic crashes, additional vehicle operating costs (VOC) and congestion-related delays.” Poor road conditions cost Texas drivers “\$5.3 billion annually—approximately \$343 per motorist,” and highway congestion in the San Antonio area costs the average driver \$765 a year.<sup>253</sup> Providing methods for transporting goods that are more cost-effective than trucks, such as rail or shipping on our national waterways,<sup>254</sup> would ease highway congestion, accidents, damage, and costs.

The Surface Transportation Authorization Act of 2009 recognizes the need to look at transportation as an “intermodal” system, rather than “stove-piping” transportation modes.<sup>255</sup> The House Committee on Transportation and Infrastructure found: “Localized congestion often has effects that ripple across the nation. The interconnected nature of the network and the broad nationwide impacts of regionalized congestion require a national response.”<sup>256</sup> The Surface Transportation Authorization Act would, if passed, re-establish and strengthen the Office of Intermodalism in order “to promote greater efficiency and provide a renewed focus on delivering intermodal solutions to the nation’s surface transportation problems” and to elevate “consideration of intermodal issues to the highest levels within the Department by creating an Under Secretary of Transportation for Intermodalism” with responsibility for the creation of a National Transportation Strategic Plan.<sup>257</sup> Intermodalism is not new. That this nation needs not just roads, but a

<sup>250</sup> FED. HIGHWAY ADMIN., U.S. DEP’T OF TRANSP., WHAT IS A SUSTAINABLE HIGHWAY?, <http://www.sustainablehighways.org/203/what-is-a-sustainable-highway.html>; see CONG. BUDGET OFFICE, A CBO STUDY: PUBLIC SPENDING ON TRANSPORTATION AND WATER INFRASTRUCTURE 13 (2010), <http://www.cbo.gov/ftpdocs/119xx/doc11940/11-17-Infrastructure.pdf>.

<sup>251</sup> *Keystone Shortway: Z. H. Confair Memorial Highway* (April 9, 2010), <http://www.pahighways.com/interstates/I80.html>.

<sup>252</sup> Phillip Longman, *Back on Tracks: A Nineteenth-century Technology Could be the Solution to our Twenty-first-century Problems*, WASH. MONTHLY, Jan./Feb. 2009, available at <http://www.washingtonmonthly.com/features/2009/0901.longman.html>.

<sup>253</sup> TRIP, FUTURE MOBILITY IN TEXAS: MEETING THE STATE’S NEED FOR SAFE AND EFFICIENT MOBILITY 1, 11, 14–15, 16 (2010), [http://www.tripnet.org/Texas\\_TRIP\\_Report\\_Nov\\_2010.pdf](http://www.tripnet.org/Texas_TRIP_Report_Nov_2010.pdf).

<sup>254</sup> Phillip Longman, *The Shipping News: Start Moving Freight by Water Again, and We’ll Use Less Oil, Emit Less Carbon, Cut Highway Traffic—and Perhaps Even Save St. Louis*, WASH. MONTHLY, July/Aug., 2010, available at <http://www.washingtonmonthly.com/features/2010/1007.longman.html>.

<sup>255</sup> STAA BLUEPRINT, *supra* note 12, at 10.

<sup>256</sup> *Id.* at 2.

<sup>257</sup> *Id.* at 11–13.

transportation system, is an insight embodied in the very name chosen for our interstate system: The National System of Interstate and Defense Highways.<sup>258</sup>

In short, we are a people long overdue for a thoughtful discussion about taxes, taxing, and their effects. Taxes are not just about money but about the meanings we attach to money. We care about whether we get our money's worth from the way tax dollars are spent, and about the decisions that government makes. The natural progression of such a discussion—if we can be honest and courageous—would begin from asking whether gas taxes are reasonable<sup>259</sup> to an exploration of who all benefits and who all pays and how they pay, to whether taxes should be state or federal to the goals for setting appropriate tax and transportation structures to meet our goals as a people.

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<sup>258</sup> Weingroff, *supra* note 234, at 4.

<sup>259</sup> *See, e.g.*, KAN. T-LINK, <http://www.kansastlink.com/> (last visited Sep. 27, 2010).

## VI. APPENDIX: EXAMPLES OF STATUTORY PROVISIONS REFERRED TO IN THE ARTICLE

**Excerpts from the Proposed Pennsylvania Turnpike Agreement****ARTICLE 1 DEFINITIONS AND INTERPRETATION****Section 1.1 Definitions. . . .**

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

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

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

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

“Material Adverse Effect” means a material adverse effect on the business, financial condition or results of operations of the Turnpike taken as a whole or the rights of the Concessionaire under this Agreement; *provided, however*, that no effect arising out of or in connection with or resulting from any of the following shall be deemed, either alone or in combination, to constitute or contribute to a Material Adverse Effect: (I) general economic conditions or changes therein; (ii) financial, banking, currency or capital markets fluctuations or conditions (either in the United States or any international market and including changes in interest rates); (iii) conditions affecting any or all of the real estate, financial services, construction or toll road industries not geographically limited to the Commonwealth; (iv) any existing event, occurrence or circumstance of which the Concessionaire has actual knowledge as of the Bid Date; (v) any action, omission, change, effect, circumstance or condition contemplated by this Agreement or attributable to the execution, performance or announcement of this Agreement or the transactions contemplated hereby, with the exception of litigation related to the execution or delivery of this Agreement or related to the legislation referred to in Section 9.1(n); or (vi) any negligence, intentional misconduct or bad faith of the Concessionaire or its Representatives.

**Section 1.12 Laws.** Unless specified otherwise, a reference to a Law is considered to be a reference to (a) such Law as it may be amended, modified or supplemented from time to time, (b)



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

### ARTICLE 3 TERMS OF THE LEASE

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

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

(i) to inspect the Turnpike or determine whether or not the Concessionaire is in compliance with its obligations under this Agreement or applicable Law pursuant to Section 8.3. -9

(ii) if a Concessionaire Default then exists, to make any necessary repairs to the Turnpike, perform any work therein and take any reasonable actions in connection therewith, including remediation of Hazardous Substances, pursuant to Section 16.1 (b)(iii);

(iii) in the event of an actual or reported emergency, danger, threat, circumstance or event that is reasonably believed by the Commonwealth or its designee (including relevant police, fire, emergency services, armed forces, and any other security or emergency personnel in accordance with Section 3.18) to have caused (or to present the imminent potential to cause) injury to individuals, damage to property, or threat to the Environment or to public safety, to take, at such times as the Commonwealth determines necessary in its discretion and with notice to the Concessionaire if practicable under the circumstances, such actions as the Commonwealth or such designee determines necessary to respond to or to rectify such emergency, danger, threat, circumstance or event;

### ARTICLE 14 ADVERSE ACTIONS

#### Section 14.1 Adverse Action.

(a) An “Adverse Action” shall occur if the Commonwealth or any Governmental Authority established under the Laws of the Commonwealth, takes action at any time during the Term (including enacting any legislation or ordinance or promulgating any rule or regulation) and the effect of such action is reasonably expected (I) to be principally borne by the Concessionaire or principally borne by private operators of toll roads in the Commonwealth; and (ii) to have a material adverse effect on the fair market value of the Concessionaire Interest, except where such action (A) is in response to any act or omission on the part of the Concessionaire or its Representatives that (1) is illegal (other than an act or omission rendered illegal by virtue of the Adverse Action), or (2) constitutes nonperformance by the Concessionaire, (B) is otherwise permitted under this Agreement or (C) is mandated by action of the United States government (or any agency thereof); provided, however, that none of the following shall constitute an Adverse Action: (w) the exercise of police, subpoena or investigatory powers of the Commonwealth or any Governmental Authority where the Commonwealth or Governmental Authority has reasonable cause to exercise such powers or take other official action under existing Law; (x) an

increase in Taxes not directed solely at the Concessionaire, the Turnpike, the users of the Turnpike or private operators of toll roads in the Commonwealth or their users; (y) Taxes for which the Concessionaire is not responsible pursuant to Section 3.10; and (2) the development, redevelopment, construction, maintenance, modification or change in the operation of any existing or new mode of transportation (including a road, street or highway) that results in the reduction of Toll Revenues or in the number of vehicles using the Turnpike.

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

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

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

Excerpts from the Chicago Parking Meter Contract.

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

(a) Subject to Section 3.12(b) and Section 3.12(e), the City will not operate, and will not permit the operation of, a “Competing Public Parking Facility.” A “Competing Public Parking Facility”

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

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

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

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

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

(b) Reserved Powers Adverse Action. A “Reserved Powers Adverse Action” shall occur if (I) the City takes any action or actions during the Term that would otherwise have constituted an Adverse Action under Section 14.1 except that such action or actions were taken by the City pursuant to its Reserved Powers, and (ii) such actions, individually or in the aggregate, are reasonably expected (A) to be borne principally by the Concessionaire or other operators of on-street metered parking systems and (B) to have a material adverse effect on the fair market value of the Concessionaire Interest after taking into account the provisions of Article 7. In addition, the events described in Section 7.10 relating to a reduction of Concession Metered Parking Spaces or

to the average of the Monthly System in Service Percentage for certain Reporting Years being less than eighty percent (80%) are each a Reserved Powers Adverse Action.

**Excerpts from the Pocahontas Parkway—Richmond, Virginia Contract.**

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

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

**Excerpts from the South Bay Expressway (SR 125) Agreement**

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

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

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

(I) directing Caltrans to acquire the Transportation Facility or portion thereof,

(ii) terminating, limiting, reducing, or abrogating the rights or benefits of Developer under this Agreement, or

(iii) regulating or interfering with Developer’s right to establish and collect tolls;

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

(I) directing Caltrans to acquire the Transportation Facility or portion thereof,

(ii) terminating, limiting, reducing, or abrogating the rights or benefits of Developer under this Agreement, or

(iii) regulating or interfering with Developer’s right to establish and collect tolls; or

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

(I) directing Caltrans to acquire the Transportation Facility or portion thereof,

(ii) terminating, limiting, reducing, or abrogating, the rights or benefits of Developer under this Agreement,

(iii) declaring illegal, void, or ultra vires any portion of this Agreement or voiding the rights of Developer under this Agreement, or

(iv) regulating or interfering with Developer’s right to establish and collect tolls.