Public Private Partnerships Gain Momentum in the United States

Public private partnerships (PPP) are in the news. In Virginia, a consortium of Skanska Infrastructure Development, Macquarie Financial Holdings and others have closed a $1.2 billion deal to finance, design and build a new tunnel under the Elizabeth River between Norfolk and Portsmouth. In California, the $490 million Long Beach Courthouse — the first major new courthouse built in California in forty years — is nearing completion by a team including Meridiam Infrastructure, AECOM Design, Clark Construction and Johnson Controls. In Texas, Governor Rick Perry has signed into law a sweeping new PPP statute and local governments are considering PPP for projects such as a state-of-the-art 500,000 square foot courthouse in Travis County. In Florida — where Balfour Beatty Campus Solutions and Capstone Companies recently completed a 1200-bed dormitory and stadium project for Florida Atlantic University — awareness of PPPs was raised when the Florida House passed a new and broader PPP statute. While the Florida Senate adjourned without acting on the bill, the trend toward increased use of PPPs in Florida shows no signs of abating.

In short, financially-constrained state and local governments are considering, and in certain instances using, PPP to provide critical infrastructure for their constituents.

While the details of individual PPP projects vary widely, PPP has generally been defined as a transaction involving a public sector authority and one or more private parties, in which the private parties agree to provide a public service or project and assume substantial financial, technical or operational risks. In a successful PPP, the objectives of the government are aligned with the profit motives of the private parties. This alignment results in a win/win project that provides “value-for-money” and the optimum amount of risk transfer to the private party.

Around the world, PPPs have been used to develop both “horizontal” infrastructure such as roads, railways, water- and waste-water treatment facilities, and “vertical” or “social” infrastructure such as hospitals, government buildings, schools and housing. The local political environment and circumstances can greatly affect the outcome of a particular PPP project. Still, a recent study in Canada shows that PPPs are developing a track record of on-time, on-budget completion for a wide variety of horizontal and vertical/social infrastructure projects. Using an analysis that compares the actual cost of private-sector delivery to a Public Sector Comparator (PSC) — a figure reflecting the all-in lifecycle cost of public sector development — the study concludes that PPP projects have delivered efficiency gains over traditional procurements as well as a high degree of cost and time certainty from financial close through completion of construction.

Generally speaking, the cost of financing a project by traditional government procurement is less than the cost of private finance. This is true because governments can typically borrow at a lower interest rate than private sector entities. Some critics focus on this single fact and conclude that PPPs can never compete with traditional procurement on the basis of cost efficiency. PPP projects can, however, finish ahead of traditionally-procured projects on a value-for-money basis, which accounts for cost savings in the management of the project (including more efficient recognition of lifetime costs and risks) and delivery of a qualitatively superior project.
Sophisticated financial models have been developed to help government owners conduct value-for-money analyses and determine which projects are good candidates for PPP. Many government owners have found that, by engaging in a value-for-money analytical process, they receive a superior project at a better price no matter what procurement method they ultimately decide to use.

Specific enabling legislation is not always required for a government entity to use PPPs to build infrastructure projects. Still, many states are enacting new PPP statutes or revising existing PPP statutes to facilitate and encourage the use of PPPs in appropriate circumstances. The National Conference of State Legislatures reports that in the past three years, the number of states with statutes creating a legislative framework for PPPs has increased by 50 percent.

An empirical study conducted by two Cornell University professors identifies the characteristics of so-called “high-intensity” PPP statutes. These characteristics include a broad definition of eligible facilities and express authorization for counties, municipalities, authorities and other lower-level governmental entities to enter into PPP contracts. High-intensity statutes also typically allow for unsolicited PPP proposals, long-term leases and concessions, and availability and capacity payments by governments to PPP developers. Other common characteristics of high-intensity PPP statutes include provisions that protect confidentiality of PPP proposals within reasonable limits, express authorization for multiple sources of funding and financing, and provisions that exempt PPP projects from otherwise-applicable public procurement rules. While no “model” PPP statute has been developed for use in the United States, most new or revised state statutes reflect these high-intensity characteristics.

Public private partnerships are not appropriate delivery systems for all infrastructure projects. PPPs are most often used for large or complex projects that do not fit neatly into traditional capital programs. A critical need for the project must exist. Criticality ensures strong public sector buy-in, which is an essential ingredient for success. Criticality also helps to ensure that the facility will operate and generate revenue over the long term. A PPP project must have a reliable revenue stream or it won’t attract investors or lenders. Ancillary sources of revenue tied to the project, such as shares of federal funds, sales taxes or impact fees, will often attract investors. Projects with a high degree of revenue risk may fail to lure investors. Historically, critical projects have included transportation and water/wastewater treatment facilities as well as social infrastructure such as schools, courthouses and hospitals.

PPP projects are also more likely to be successful when there is a clear definition of the public’s needs and desired outcomes. Ideally, the government owner will express its needs and desires in specific written measures of performance. Finally, PPPs are most likely to succeed when there is top-down leadership, bottom-up support, and a financial value-for-money analysis that shows private financing to be a competitive alternative to public financing.

Estimates of the amount of private money “on the sidelines” and available for deployment on quality PPP projects around the world range from $2 trillion to $4 trillion. Under the right circumstances, PPP projects in the United States can successfully compete for those funds. When used properly, PPPs can generate win/win/win outcomes for government owners, public users and private investors.
In American Underground Engineering, Inc. v. City of Syracuse, the City hired a contractor to construct a parking deck and the contractor sued the City for breach of the contract. The contractor proved at trial that the City had breached the contract, and that the breach was so material it defeated the purpose of the contract. The jury awarded the contractor damages based on the contractor’s costs of performance, plus overhead, minus payments from the owner. In post-trial motions, the City argued that the jury impermissibly used a quantum meruit calculation when awarding damages, which would be inappropriate due to the existence of a written contract.

Rejecting the City’s arguments, the District Court, applying New York law, held that if a written contract has been wrongfully terminated, then a quantum meruit measure of damages can be used. The court also held that the wrongful failure to make payment or the wrongful imposing of delays upon the contractor’s performance of the work, can be so material a breach that it justifies the conclusion that the contract has been wrongfully terminated by the owner. In such a situation, damages calculated on the basis of a quantum meruit theory of recovery can be recovered. As stated by the court, “Once an agreement has been wrongfully terminated, the non-breaching party may elect to pursue quantum meruit damages. Where a party seeks quantum meruit damages for the premature wrongful termination of a construction contract, courts calculate the damages by considering the actual job costs plus allowance for overhead and profit minus amounts already paid.”

Although this case applies New York law and the same result may not be obtained in another jurisdiction, this case illustrates how quantum meruit can be used as a theory of recovery if a contract-based measure of damages is insufficient to fully compensate the damaged party.

American Underground Engineering, Inc. v. City of Syracuse, No. 5:00-CV-278 (FJS/DEP), 2011 WL 4809882 (N.D.N.Y. October 11, 2011).

State of New Jersey v. Perini Corporation addresses the application of a statute of repose to a multi-phase construction project. The State filed suit against four contractors that took part in the construction of a prison in the mid-1990s. The project’s hot water system was defective and required replacement. New Jersey has a ten year statute of repose, triggered by the “performance or furnishing of such services and construction…” The boilers and most of the piping were installed as part of Phase I of the project, completed more than ten years prior to the commencement of the action. The prison was also occupied more than ten years before the suit was filed. Less than ten years had elapsed, however, from the date the last phase of the project was completed, and the certificate of substantial completion was issued for the entire project. The issue before the court was the date the repose period commenced on a multi-phase project.

The court rejected the argument that the use of the hot water system more than ten years before the filing of the suit rendered the claim untimely. The hot water system was not a separate improvement to the property, but was a part of the work performed in all of the phases. The contract identified three phases of construction with separate deadlines for completion and liquidated damages applicable to each deadline. The parties used certificates of substantial completion to pinpoint the dates when buildings and other work were completed and ready for use. Temporary certificates of occupancy were obtained for completed buildings. The evidence established that Phases I and IIA of the contract were substantially completed more than ten years before the suit was filed, but as to Phase II, certificates of substantial completion were issued within ten years of the filing of the suit and the hot water system was a component of Phase II of the project.

The court accepted the argument that multiple phases of a construction project that are clearly identified and documented can trigger separate periods of repose, even for the general contractor and other contractors that continue to work on the entire project. While separate periods of repose can exist for each phase of a project clearly identified as such in the construction documents, the court rejected the application of separate trigger dates for components of a project, whether multi-phase or not, that are not clearly identified in the construction documents as distinguishable improvements to real property.

Because the hot water system was not identified in the contract and other construction documents as a separate “improvement” that was substantially completed before completion of all buildings to which it was connected, a separate trigger date for the statute of repose did not exist for the hot water system. Instead, the trigger date was when each of the contractors to whom the statute of repose applied substantially completed its work on the entire project. Using this date, the court concluded that the State’s complaint was timely filed.

A cautionary tale about the consequences of disregarding the separateness of a corporate entity is told in the recent case of Christopher v. Sinyard out of Georgia. Here, a company created to construct personal residences promised to complete punch list items after the closing of a sale, and at closing one of the corporation’s officers executed a seller’s affidavit stating that the residence had been completed and that the work and materials were warranted for one year. Five days after the closing, the homeowner met with the builder to discuss the punch lists and the fact that subcontractors were threatening to place liens on the house. When the builder reviewed the punch lists with the homeowner, the builder stated that he could not help and drove away. According to the builder, there was no money left after the closing, and the work was not completed because “we were out of money.”

The homeowner sued and obtained a default judgment against the company and then sought to pierce the corporate veil and hold the officers of the company personally liable for the default judgment. The trial court pierced the corporate veil and held the officers personally liable in the face of evidence that the corporate officers had commingled corporate and personal properties and records; failed to observe corporate formalities; the corporation was under-capitalization; and fraud was committed at the closing by executing a seller’s affidavit the officers knew was false. The evidence also showed that the officers never signed bylaws, never issued stock certificates, never kept meeting minutes, never filed annual registrations after 2005, titled lots personally then transferred them at or near closing, the company did not have a physical location, transferred funds obtained during construction to the officers’ other businesses, made undocumented loans to the company, and paid the company’s creditors from their personal funds.

While the officers argued that it is common for small companies to disregard certain corporate formalities, the appellate court showed little sympathy. The Court of Appeals held that “if the individual who is the principal shareholder or owner of the corporation conducts his private and corporate business on an interchangeable or joint basis as if they were one, then he is without standing to complain when an injured party does the same. Under such circumstances, the court may disregard the corporate entity.”


In the South Carolina case of 16 Jade Street, LLC v. R. Design Construction Company, the court wrestled with the scope of protection from tort liability provided to individual members of a limited liability company. This issue arose when a condominium project owner filed suit against an LLC that acted as the general contractor on a project. The owner also asserted claims against the individual member of the LLC, alleging negligence and breach of warranties as a consequence of defects in the construction of the condominium building. The question raised was whether the Uniform Limited Liability Company Act, under which the LLC was created, shielded the individual member from personal liability for the alleged negligence.

As enacted in South Carolina, the pertinent section of the Uniform Limited Liability Company Act provides that “the debts, obligations, and liabilities of a limited liability company, whether arising in contract, tort, or otherwise, are solely the debts, obligations, and liabilities of the company” and that “a member or manager is not personally liable for a debt, obligation, or liability of the company solely by reason of being or acting as a member or manager.”

Acknowledging that the statute’s language may be read to shield a member from personal liability for torts he commits in furtherance of the LLC’s business, the court nonetheless adopted what it characterized as the “majority position” and held that this language only protects non-tortfeasor members from vicarious liability and does not insulate the tortfeasor himself from personal liability for his actions.

The dissent rejected the majority’s approach, finding the statute clear and unambiguous, and not susceptible to the interpretation that a member tortfeasor of an LLC is personally liable for torts committed in the furtherance of the LLC’s business.

As noted in the opinion, there is an emerging split of authority over the scope of the protection afforded under the Uniform Limited Liability Company Act. The approach adopted in South Carolina, limiting the protection to vicarious but not direct liability, appears to remove one of the main reasons contractors and owners create LLCs.

OTHER CONSTRUCTIVE THOUGHTS
UPCOMING SPEAKING ENGAGEMENTS AND PUBLICATIONS OF ALSTON & BIRD’S CONSTRUCTION GROUP

In October, Jeff Belkin and two colleagues, including regulatory counsel for UPS and an Assistant United States Attorney, are speaking at the Society for Corporate Compliance and Ethics’ (SCCE) 11th Annual Compliance & Ethics Institute in Las Vegas on the anatomy of a government investigation, from inside counsel outside counsel, and government attorneys. Compliance professionals and lawyers are encouraged to attend the premier compliance organization’s convention, and registration is available at http://dev.complianceethicsinstitute.org/.

Andy Howard is speaking on the topic of conducting business across state lines at the ABA Forum on the Construction Industry’s fall meeting, scheduled for October 18 and 19 in Boston.

Alston & Bird’s Construction & Government Contracts Group will be hosting a seminar for construction project owners in fall of 2012. The seminar will be held in Atlanta, Los Angeles and Washington, D.C. Further details forthcoming.

ALSTON & BIRD CONSTRUCTION GROUP
HTTP://WWW.ALSTON.COM/SERVICES/LITIGATION/CONSTRUCTION/

Group Leaders
Chris Roux chris.roux@alston.com 202-239-3113 / 213-576-1103
John Spangler john.spangler@alston.com 404-881-7146

Group Members
Jeff Belkin jeff.belkin@alston.com 404-881-7388 / 202-756-3065
Steven Campbell steven.campbell@alston.com 404-881-7869
Debbie Cazan debbie.cazan@alston.com 404-881-7667
Kevin Collins kevin.collins@alston.com 213-576-1184
Dan Diffley dan.diffley@alston.com 404-881-4703
Andy Howard andy.howard@alston.com 213-576-1057
Bill Hughes bill.hughes@alston.com 404-881-7273
Scott Jarvis scott.jarvis@alston.com 404-881-7438
Kate Miller kate.miller@alston.com 404-881-7947
Kyle Ostergard kyle.ostergard@alston.com 213-576-1036
Mike Shanlever mike.shanlever@alston.com 404-881-7619
Jessica Sharron jessica.sharron@alston.com 213-576-1164
Nathan Sinning nathan.sinning@alston.com 213-576-1134