Invited Testimony of Brian Cassidy
Before the
Legislative Study Committee on Private Participation in Toll Projects
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Good morning. My name is Brian Cassidy, and I am a partner in the law firm of Locke Lord Bissell & Liddell LLP. Our firm represents many of the tolling authorities throughout the state, and I have personally worked extensively with several of the regional mobility authorities (RMAs) which have been formed in the past 5-1/2 years.

I appreciate the opportunity to testify before the Committee. My testimony, which addresses several issues related to private participation in toll projects as well as other issues generally related to Senate Bill 792, is set forth below.

RMA OVERVIEW

Existing RMAs

There are currently eight RMAs in the state. They are:

1. Alamo RMA (Bexar County)
2. Cameron County RMA (Cameron County)
3. Camino Real RMA (City of El Paso)
4. Central Texas RMA (Travis and Williamson Counties)
5. Grayson County RMA (Grayson County)
6. Hidalgo County RMA (Hidalgo County)
7. North East Texas RMA (12 counties: Smith, Gregg, Cherokee, Harrison, Rusk, Upshur, Bowie, Cass, Panola, Titus, Van Zandt, and Wood)
8. Sulphur River RMA (Delta, Hopkins, Hunt and Lamar Counties)

The varied composition and geographic diversity of these existing RMAs demonstrates the flexibility of the RMA model. Whether an area is urbanized and in need of serious congestion relief (such as Central Texas and Bexar County), is less urban (or rural) and in need of enhanced infrastructure for economic development purposes (such as North East Texas), or is facing increased border trade traffic (such as Cameron County), the RMA model works.

Local Formation/Local Control

RMAs are formed at the request of local entities—in most cases by one or more counties that have chosen to form an RMA for a specific project or purpose. They are governed by a board of directors appointed by the entities forming the authority, with the chairman of the board appointed by the Governor. The result is that RMAs are *locally* formed and *locally* controlled, and these are characteristics which have been vital to their success. As the lack of adequate funding has forced the state to rely on tolling as a means of financing new roads (or the

expansion of capacity in existing corridors), potential toll projects have been met, in some areas, with political and citizen opposition. However, the prospect that tolling will be implemented and administered by a locally controlled entity has helped to garner the support and confidence of local leaders and elected officials. That support has resulted in several important projects being advanced notwithstanding the lack of traditional funding.

COMPREHENSIVE DEVELOPMENT AGREEMENTS

RMAs are governed by Chapter 370 of the Transportation Code, which was a component of HB 3588 enacted in 2003. Chapter 370 provides that RMA's are authorized to develop a wide-range of transportation projects, and they are also granted a variety of tools by which to procure the development of those projects. Among those tools are comprehensive development agreements, or CDAs. At a minimum, CDAs must incorporate the design and construction elements of a project. A CDA may also include (in addition to design and construction) finance, operations, and maintenance functions. Set forth below are recommendations for ensuring that CDAs continue to be available to RMAs as a tool for advancing needed transportation projects while protecting and fostering the local control discussed above.

Distinguishing Between Concession CDAs and Design/Build CDAs

If a CDA incorporates only the design and construction elements it is often referred to as a "Design/Build CDA", whereas if it also includes the finance, operations and maintenance features it may be referred to as a "Concession CDA". Unfortunately, the generic term "CDA" is often used in reference to a concession arrangement, and that generic reference can lead to confusion. That confusion can even be seen in elements of SB 792. For example, Sections 371.051 and 371.052 of the Transportation Code (added by SB 792) require Attorney General review and public hearings on CDAs (which would include Design/Build CDAs), but the terms referenced as the subject of review (i.e., financial forecast of revenues during the "planned term of the agreement" and the amount of income the "private participant" will realize during "the planned term") are characteristics of Concession CDAs. Similar confusion appears in Section 371.151 relating to publication of information regarding contracts for construction. In contrast, the provisions of SB 792 that accelerate the expiration of CDA authority for TxDOT and RMAs recognize the distinction by providing that Concession CDA authority expires August 31, 2009, but authority for other CDAs (i.e., Design/Build CDAs) expires August 31, 2011. (See 223.201 and 370.305, referring to CDAs that "do not grant a private entity a right to finance a toll project…".) *The Committee should consider recommending that the Legislature clarify the distinction between different types of CDAs and also clarify the intended application of Sections 371.051 and 371.152.*

Protecting Local Decision Making Regarding Concession CDAs

The CDA powers granted under Chapter 370 are important to RMAs. Design/Build CDAs allow RMAs to transfer certain risks to project developers while receiving commitments for a guaranteed project delivery date at a guaranteed price. That certainty is welcomed by rating agencies and investors, particularly for start-up entities which have little in the way of financial resources to absorb the financing and other costs associated with project delays. Concession

CDAs can also be used by RMAs (subject to the moratorium provisions of SB 792), and while controversial in some areas, they may be viewed as a desirable project delivery method in others. *Consistent with the principles of local control discussed above, the Committee should consider recommending to the Legislature that RMAs, in conjunction with their local partners, be allowed to make local decisions about whether to use a Concession CDA for a project. In other words, remove the moratorium on concessions and leave that delivery method as an option (but in no way a requirement) for RMAs.*

Ensuring Adequate Safeguards for Concession CDAs

The preceding recommendation assumes that adequate safeguards are built into the Concession CDA process so as to protect the public interest. In particular, concerns over "buy-back" provisions and non-compete clauses have led to much of the public opposition and (as evidenced by the formation of this Committee) legislative scrutiny concerning Concession CDAs. Improvements to those areas will enhance public confidence.

"Buy back" provisions refer to the right of a toll authority to acquire the continuing financial and operational interest of a concessionaire in a project. State law is clear that ownership of a project will always remain with the public entity (e.g., an RMA; see 370.309). However, a private entity's rights to lease, operate, and collect tolls on a project may last for up to 52 years. Buy backs are an important measure of protection that assures the public and the toll authority that the tolling authority can regain full control in the event issues arise with the concessionaire or if local preferences change concerning private operation of a public asset. Note that these clauses do not pertain to breach of a Concession CDA, as those events would be addressed through a separate set of rights and remedies in the agreement. Instead a buy back facilitates what is commonly known as a "termination for convenience". While existing law generally requires that a buy back provision be included in a Concession CDA (see, e.g., 370.311(b)), no guidance was given as to how the buy back should be structured or the amount determined. SB 792 tried to address this deficiency by adding more detail as to how buy back clauses should work, but there may still be opportunities to improve on that structure and add more certainty to the process. *For example, the Committee may want to consider recommending to the Legislature that buy back clauses be structured so that buy outs can occur at specific points in time and for amounts that can be easily determined.* These amounts would, of course, need to incorporate fair recognition of the investment made, and risk assumed, by a concessionaire.

Non-compete clauses relate to restrictions on the ability of a toll authority to construct new facilities (or add capacity to existing facilities) that may adversely affect the revenue performance of the project which is the subject of the Concession CDA. SB 792 added provisions which prohibit incorporating any restrictions in a CDA on the construction of new facilities, and instead allow the parties to address the construction of new facilities as a financial issue by providing for compensation if a new facility has a positive or negative financial impact on the Concession CDA project. Projects which are already included in the STIP or an MPO's plan are excluded (as are safety and other projects), and the geographic limit for consideration of the effects of a facility is four miles in each direction of the centerline of the project. In essence this approach replaces a "non-compete" clause with a "compensation for competing facilities" clause. *The Committee may want to consider recommending that the Legislature add additional detail as*

to how the compensation amount is to be determined for Concession CDA projects, such as what type of supporting data is required and over what period of time.

ADDITIONAL RMA ISSUES

Local Partners: TxDOT Districts and MPOs

While local control has been instrumental in fostering acceptance of tolling, the partnerships between RMAs, their local metropolitan planning organizations (MPOs), and TxDOT have been just as essential in successfully advancing RMA projects. In nearly all instances where RMAs have been able to move projects forward the local TxDOT district has been an active and supportive partner in the process. Much of what RMAs do is subject, at some level, to TxDOT oversight, and a strong working partnership between an RMA and TxDOT is critical to the success of a project.

Likewise, MPOs are an essential partner to RMAs. In essence, MPOs are planning entities for a region and RMAs are implementing entities. RMAs generally cannot advance projects that are not in an approved long range transportation plan and/or transportation improvement program of an MPO. Important funding decisions are also made in concert with MPOs, and SB 792 gives MPOs the right to approve the business terms (such as toll rates and toll rate escalations) that are incorporated in the market valuation for a toll project in the region. While this is an appropriate "check" on the terms for the first toll project in a region (and protects against "forced" standards resulting from the market valuation process that are higher than the region is willing to accept), it may be unnecessary for other projects (or extensions of existing projects) that incorporate the same terms. *Therefore, the Committee should consider recommending to the Legislature that Section 228.0111(g) be revised to require MPO approval of business terms for the first toll project in a region and thereafter for only those projects for which the business terms differ from those previously approved.*

Funding Challenges

While the RMA model has been successful at generating local support for projects and advancing projects to the development (and operational) phase, RMAs face serious funding challenges. Initially, RMAs need funds to develop the organization, hire core staff and consultants, and establish and implement administrative policies and procedures so that the RMA can responsibly manage the development of projects that can cost several hundred million dollars. When securing funding for projects from the capital markets (through the issuance of toll revenue bonds) RMAs will initially be viewed as "start-up" entities. They have no track record of successfully developing and operating projects, so rating agencies and investors will look closely at the management and administration of an RMA. An RMA needs to be viewed as creditworthy in the eyes of those investors and analysts to secure project funding, and that requires the institutional and organizational development described above. Currently, funding for that start-up activity falls mainly to the local entities that created the RMA, but often they do not have sufficient funds available to fully support the RMA through the start-up process. TxDOT makes some funding available through project-related financial assistance for pre-development activities, but that funding takes time to obtain and may be restricted to use for a

specific project (with some allowance for indirect expenses). *The Committee should consider recommending to the Legislature that TxDOT be authorized to dedicate certain funds that can be loaned to RMAs to specifically help them during their start-up phase. The loans can be repaid upon the achievement of a project financing or from later operating revenues once a project is open to traffic.*

Even a more serious funding challenge faces RMAs when they seek to secure project financing. A typical toll road financing is comprised of toll revenue bonds, local contributions (i.e., right-of-way or other funding), in some instances a TIFIA loan (administered by the US Department of Transportation), and TxDOT loans or grants. However, TxDOT's recent financial challenges are well-known, and the department has little money to make available for new projects. Therefore, RMAs need all of the alternative funding tools they can get. *Toward that end the Committee should consider recommending to the Legislature that:*

(1) A fund be established within TxDOT (perhaps using a portion of the Proposition 12 bonds) that can be used to provide credit assistance for RMA projects (i.e., loans, grants, commitments to "backstop" operations and maintenance costs, etc.). This could be a revolving fund, with assistance made available in the form of loans that would be repaid to the fund.

(2) A state infrastructure fund be established from which project financing could be borrowed (similar to the TIFIA program administered at the federal level).

(3) Funding for pass-through projects be restored and enhanced. Pass-through funds can be used for tolled and non-tolled projects.

(4) An optional vehicle registration fee be authorized for all counties with RMAs (similar to HB 3437 enacted last session for Cameron and Hidalgo Counties).

Market Valuation

SB 792 has, in general, proven to be beneficial for RMAs. The "local primacy" provisions (granting local toll authorities a right of first refusal for local toll projects) have helped to bolster the perception of local control as discussed above. Clarifying that the use of state-owned right-of-way will be at no cost to an RMA (other than third-party reimbursements) is also a positive feature. The market valuation process, however, has proven to be challenging. It appears from the context of the statute (and based on guidance provided during previous legislative hearings) that the process is generally intended to determine whether a toll project has a positive economic value based on an assumed (and mutually agreed upon) set of terms, conditions, and assumptions, and if so to determine the amount of that economic value. If there is a positive economic value, then a local toll entity must, as a condition of exercising its "primacy " rights to the project, agree to either make a financial commitment to the region (through deposit to a subaccount) in an amount equal to the market valuation, or contractually commit to build projects with a value equal to the market valuation amount. (See 228.0111(g)(1) & (2).) Recognizing that RMAs do not have established systems and would therefore be unable to make the required subaccount payment or contractual commitment to build other projects, RMAs were given a third option- to pledge that any surplus revenues from the project would be used for other

transportation projects in their region (up to the amount of the market valuation). (See 228.0111(g)(3).)

In practice the market valuation process has become complicated, time consuming and expensive. There is little statutory guidance as to specific reference points for terms and conditions, so much has been left to policy determinations as the process has evolved. There have been some rather high-profile disputes over these policy determinations in the North Texas area, where projects (such as SH 161) have the potential for significant positive market values. However, most RMA projects face significant financial challenges, and are unlikely to have positive market values. Nevertheless the negotiations have begun and disputes over policy issues have arisen. *This leads to four recommendations for the Committee to consider recommending to the Legislature: first, consider eliminating the market valuation process altogether.* Allow local toll authorities to decide, in conjunction with their MPOs, whether they wish to explore a private sector option. If so they can obtain a market analysis of the project's value, but through a process they control rather than an adversarial process where they are pitted against TxDOT. Let a region decide the path it wants to take, even if that path does not maximize the immediate dollars a project might generate. Since payments received from a concession must stay within a region anyway, let the region decide whether it wants the money a concession can bring to accelerate other projects. The market valuation process leaves no room for community values in the economic analysis that is required, and those values may be of more importance to a community than the up-front dollars a concession might generate. *Second, and if the market valuation process continues, add definition and guidance to the process, requiring, for example, that any financing structure utilized must be one that would secure a preliminary investment grade rating.* This seems particularly appropriate since the private sector delivery method (i.e., concession) is not even available for most RMA projects. *Third, provide legislative direction that market valuations should be waived where a preliminary analysis indicates that the result will be a negative value.* These cases seem particularly appropriate for invocation of the "waiver" provision of SB 792 (allowing the market valuation to be waived by agreement of the parties), but in practice TxDOT has been reluctant to do so. *Fourth, in areas where an RMA is able to develop a project through a Concession CDA and chooses to do so, no market valuation should be required. The concession process will provide the best evidence of the market value, and the process required by SB 792 is unnecessary.*

One additional aspect of the market valuation process is the effect of "terms and conditions" that are agreed upon during the negotiations. The primary terms agreed upon are toll rates and toll rate escalations. SB 792 provides that these terms must be used in the development of the project. (See 228.0111(g).) The problem this raises is that these terms may be agreed upon several months (if not years) before a project financing is finalized. Financing structures, market conditions, traffic studies, and various other factors can all change in ways that may require adjustment to these terms. *Flexibility should be built into the requirement that the terms and conditions agreed upon during market valuation negotiations be used in the course of project development (i.e., perhaps require that the terms be used "subject to adjustments required for project finance reasons").*

SUMMARY OF RECOMMENDATIONS

The Committee may want to consider the following recommendations to the Legislature:

- Clarify the distinction between different types of CDAs, while also clarifying the intended application of Sections 371.051 and 371.152.

- Allow RMAs, in conjunction with their local partners, to make local decisions about whether to use a Concession CDA for a project by removing the moratorium on concessions and leaving that delivery method as an option (but in no way a requirement) for RMAs.

- Require that buy back clauses in Concession CDAs be structured so that buy outs can occur at specific points in time and for amounts that can be easily determined.

- Add additional detail as to how the compensation for construction of competing facilities is to be determined for Concession CDA projects, such as what type of supporting data is required and over what period of time.

- Revise Section 228.0111(g) to require MPO approval of business terms for the first toll project in a region and thereafter for only those projects for which the business terms differ from those previously approved.

- Consider legislation authorizing TxDOT to dedicate certain funds that can be loaned to RMAs to specifically help them during the start-up phase.

- Authorize creation of alternative funding tools for RMAs, including:

  (1) Establishing a fund within TxDOT that can be used to provide credit assistance for RMA projects.

  (2) Establishing a state infrastructure fund from which project financing could be borrowed.

  (3) Restoring (and enhancing) funding for pass-through projects.

  (4) Authorizing an optional vehicle registration fee for all counties with RMAs.

- Consider eliminating the market valuation process in favor of letting local entities decide which project delivery method to use.

- Add definition and guidance to the market valuation process, requiring, for example, that any financing structure utilized must be one that would secure a preliminary investment grade rating.

- Provide legislative direction that market valuations should be waived where a preliminary analysis indicates that the result will be a negative value.

- Provide that a market valuation is not required when an RMA elects to develop a project through a Concession CDA.

- Build flexibility into the requirement that the terms and conditions agreed upon during market valuation negotiations be used in the course of project development (i.e., require that the terms be used "subject to adjustments required for project finance reasons").