PUBLIC–PRIVATE PARTNERSHIPS: STRUCTURING THE REVIVAL OF FISCALLY DISTRESSED MUNICIPALITIES

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PPPs have potential to be a valuable tool for cash-strapped municipalities to make necessary infrastructure improvements and improve their financial future. However, there is a potential for abuse of this structure if officials lease assets to cover current costs without providing any future benefits. Projects that do not take advantage of the structure by shifting much of the risk—especially demand risk—onto the private partner are less likely to be successful for the public partner. Since the existence of PPPs is dependent on authorizing laws at the state level, states should develop a strong legal framework that limits projects to those that shift sufficient risk and do not burden municipalities with significant future costs.

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INTRODUCTION

Public-Private Partnerships ("PPPs") have received increased media attention due to their widespread use in the United States, and their promotion by both the Obama and Trump administrations.¹ Much of the focus has been on the

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United States’ subpar infrastructure and the potential for these long-term agreements with private actors to improve its infrastructure in an efficient manner. Other countries, such as the United Kingdom and Canada, have used PPPs heavily for the past few decades. The United States has traditionally opted for financing infrastructure projects through issuing bonds, due to the robust municipal bond market that has sprung out of the federal tax exemption for these instruments. But decaying infrastructure and large amounts of municipal debt have driven an increasing interest in this type of project structure.

In this paper, I will argue that PPPs can be a valuable tool for cash-strapped towns and states to revitalize their infrastructure, but that deals must be structured appropriately, with sufficient oversight and transparency, to ensure that goal. Part I will introduce the concept of PPPs and the variety of forms they take. Part II will explore the legal framework for these projects at the federal, state, and local level. Part III will discuss typical risk allocation in PPP contracts, and how different risk allocation schemes affect a project’s long-term prospects. Part IV will explore the arguments for and against this project structure, and evaluate whether PPPs offer a unique mechanism to finance projects and gain efficiency. Part V will suggest contractual and legal mechanisms to constrain the adverse impacts explored in Part IV and reap the maximum benefit from this project structure.

I.
What is a PPP?

A. The Concept of PPPs

Critics of PPPs may allege that they are just a “less politically charged rebranding of privatization,” but there are several aspects of PPPs that distinguish them from traditional privatization or government-funded projects contracted out to

2017/06/06/business/dealbook/trump-infrastructure-plan-privatized-tax
payers.html.

2. See Goldstein & Cohen, supra note 1; DIANE WHITMORE SCHAZENBACH,
RYAN NUNN & GREG NANTZ, THE HAMILTON PROJECT, IF YOU BUILD IT: A
GUIDE TO THE ECONOMICS OF INFRASTRUCTURE INVESTMENT 1, 9 (2017).

private construction companies. The public partner remains the owner of a project throughout the life of a PPP, but contracts out the design, build, financing, operation, and maintenance to a private partner for a long term, typically several decades. The long timespan of the project and the private partner’s multiphase accountability provide for more risk sharing between the partners. Additionally, since the private partner has a stake in the later phases of a project, they are more likely to be efficient and favor high-quality work in earlier phases to maximize long-term savings and deliver more value for money.

B. Different Types of PPPs

PPP are primarily used as a project vehicle for infrastructure projects; two of the most common assets in the United States for its application include roads and water treatment systems. PPPs can be structured in a multitude of ways, depending on both the number of phases managed by the private partner, and payment structure.

1. PPP Varieties Based on Phases

A design & build (“DB”) project is the most simple form of PPP, but it does not capture the full benefits of more traditional PPPs. This structure is virtually the same as a traditional government infrastructure project where financing is raised through issuing bonds, and then the government accepts bids from private contractors to execute the project. These projects vary from traditional PPPs because they are not long-term arrangements—they do not extend beyond the construction of the project—and do not provide the benefits of risk sharing, and value for money that contractors who have skin in the

7. Id. See also Sabol & Puentes, supra note 5, at 11; Schazenbach, Nunn & Nantz, supra note 2, at 9.
game for the full length of the project may deliver. Operation & Maintenance (“OM”) PPPs fit the mold a little better, since they are likely to be long-term contracts, but an OM project will not benefit from the higher quality work done at the DB phase that a full-term PPP would.

A project that involves the design, build, operation, and maintenance (“DBOM”) phases of a long-term project is basically a full-term PPP, but the government still finances the project, likely through issuing bonds. A design, build, operation, financing, and maintenance (“DBFOM”) PPP shifts the responsibility and risk of each phase of the project to the private partner, while retaining ownership for the public partner. PPPs also commonly split the financing phase, with the government providing some of the money through issuing bonds, and the private partner providing funds through bonds of its own or borrowing money. Both of these structures capitalize on the value gains potentially provided by contractors seeking to maximize savings and profits throughout the life of the project.

2. Payment Structures

The private partner in a PPP can either receive their payment directly from the users of the project or through regular payments from the government. The private partner can receive their payment directly from users through tolls, water rates, or other user fees. Alternatively, the public partner may provide the private partner with “availability payments” conditioned on the private partner keeping the asset available for public use and in good condition. In Part III, I will further discuss how the choice between these structures impacts the project’s risk allocation. Additionally, I will consider how

9. See infra Section IV.A.2. See, e.g., Aaron M. Renn, Manhattan Inst., The Lessons of Long-Term Privatizations: Why Chicago Got it Wrong and Indiana Got it Right 5–10 (2016) (discussing the OM PPPs of Chicago and Indianapolis’s parking meters, for seventy-five and fifty years, respectively).
11. Id. at 7.
12. See infra Section II.B.
13. Schazenbach, Nunn & Nantz, supra note 2, at 8.
14. Id.
supervening events may affect the payment structure. PPP contracts may also provide for the private partner to give a lump sum payment to the public partner at the beginning of the project, or reserve a portion of tolls or fees collected for the public partner.\footnote{15}

II. LEGAL FRAMEWORK

A. State Legislation Authorizing PPPs

In the United States, there is no federal legislation authorizing PPPs, so municipalities can only enter into PPPs if the state has granted them the requisite legal authority.\footnote{16} Thirty-three states, the District of Columbia, and Puerto Rico have passed legislation authorizing at least some form of PPPs.\footnote{17} States differ on how many phases of a PPP are authorized, what agencies or municipalities may enter into a PPP, and what types of infrastructure projects are allowed.\footnote{18}

Nine states, District of Columbia, and Puerto Rico prohibit non-compete provisions, which are commonly used in PPPs to prevent the public partner from opening a competing toll road or other asset.\footnote{19} However, Texas, for example, still allows contracts to require the public partner to provide the private partner with revenue losses attributable to competition from their new project, unless the project was already part of a transportation plan that existed at the time of contract formation, the project consists of necessary improvements for safety or maintenance, the project is the creation of high occupancy


\footnote{17} Id. at 176; Kevin Pula, Nat’l Conf. of St. Legislatures, Publ.–Private Partnerships for Transportation: Categorization and Analysis of State Statutes 6 (2016).

\footnote{18} Edwards, Hafer & Reidy, supra note 16, at 176. See Pula, supra note 17, at 14–22. Many states specifically authorize PPPs for transportation and designate the state Department of Transportation (DOT) as the public partner. Id.

\footnote{19} Pula, supra note 17, at 30. See Goldstein & Cohen, supra note 1 (discussing the problematic non-compete provision in the lease of California State Route 91).
vehicle ("HOV") lanes required by an environmental regulatory agency, or the project is for a different mode of transportation than the original PPP.  

Sixteen states, District of Columbia, and Puerto Rico, have legislation that limit the term length for PPP agreements. Twenty-six states and Puerto Rico require state legislature approval, review or other involvement; twenty-four states, District of Columbia, and Puerto Rico require approval, review or other involvement by other state, local or federal entities. Legislation in twenty-nine states, District of Columbia, and Puerto Rico addresses tolling and rate-setting authority, with nine states, District of Columbia, and Puerto Rico specifying how and when rates can be changed. State legislation authorizing PPPs attempts to strike a balance between promoting efficient, beneficial PPPs, and preventing officials from entering into agreements that will ultimately harm the public.

B. Public Financing of PPPs

Most PPPs have some amount of public funding, which state and local governments usually generate by issuing bonds—including municipal tax-exempt bonds, direct pay bonds, and Private Activity Bonds ("PABs")—and federal funding through Transportation Infrastructure Finance and Innovation Act ("TIFIA") or Water Infrastructure Finance and Innovation Act ("WIFIA"). Municipalities can issue tax-exempt general obligation bonds to generate money for a PPP. Municipalities can only issue general obligation debt to the extent of the debt limits imposed by their state constitution. Municipalities can easily circumvent debt limits by issuing toll revenue bonds.

21. See Pula, supra note 17, at 23–30 (comparing term limits ranging from thirty-five years to ninety-nine years).
22. Id. at 36.
23. Id. at 54.
24. See Pula, supra note 17, for further comparisons of state’s PPP legislation. See infra Section V.B for a discussion on what legal requirements are advisable.
bonds, which are guaranteed by revenues from the tolling project, rather than general tax revenue.26

Direct pay bonds, unlike normal municipal tax-exempt bonds, are taxable, and the federal government directly subsidizes interest expense; these are intended to attract a wider range of investors than normal municipal bonds.27 The now defunct Build America Bond program instituted by the Obama administration from 2009 to 2010 was an example of direct pay bonds: over $185 billion of these bonds were issued during the life of the program, which equated to $20 billion in savings for issuers compared to tax-exempt bonds.28 President Obama proposed a similar direct pay bond program named America Fast Forward Bonds in his 2015 budget, but they were not ultimately adopted.29 PABs are typically a significant portion of PPP financing; state or local governments issue these bonds on behalf of the private partner.30 From 2008 to 2013, 17% of PPP project value and 25% of PPP project debt took the form of PABs.31

State and local governments may also apply for TIFIA or WIFIA funding, for transportation or water treatment infrastructure projects, respectively.32 TIFIA accounted for 23% of total PPP project value and 35% of PPP debt from 2008 to 2013.33 TIFIA funding is available from the Department of Transportation as secured loans for up to 49% of project cost with a low, locked interest rate for thirty-five years, loan guarantees, or lines of credit.34 WIFIA is a similar low-interest loan program administered by the EPA for water and water treat-

26. See Pula, supra note 17, at 54 (finding that legislation in eighteen states and Puerto Rico allows the public sector to issue toll revenue bonds).
27. See Expanding Our Nation’s Infrastructure, supra note 25, at 10.
28. Id.
29. Id. See also Obama’s State of the Union Wins and Losses, POLITICO (Jan. 12, 2016), https://www.politico.com/story/2016/01/state-of-the-union-2016-proposals-21760.
30. See Expanding Our Nation’s Infrastructure, supra note 25, at 10.
31. Id.
33. See Expanding Our Nation’s Infrastructure, supra note 25, at 9.
ment infrastructure. Both programs are available for projects structured as PPPs.

III.

Risk Allocation

One of the key differences between PPPs and traditional debt financing is the ability to share risk through the joint venture. The more phases of the project a private partner takes on, the more risk the public partner shifts onto them; in the most basic form of PPP, a design-build, the private partner is only exposed to risk during the design and construction of the project, after which responsibility for, and the risk of, the project, returns to the public. Aaron Renn, a senior fellow with the Manhattan Institute who has done considerable research on PPPs, claimed that the most important question regarding a potential PPP “is who bears the revenue risk if certain things happen.”

Typically, PPPs allocate risk to the party in control of that risk, but some risks are not really in the control of either party. In such situations, risk should be assigned to the party that is (1) “better able to control the occurrence of the risk (risk frequency) and (2) . . . better positioned to manage the outcome of the risk, or control its ultimate cost (consequence severity).”

A. Risk Exposure for Public Partner

The public partner typically bears the risk for supervening events that are under its control, or which it is in the best place to manage. These are often called Compensation Events,

35. Id. at 184–85.
37. Making the Most of Public-private Partnerships, Knowledge@Wharton (June 10, 2015), http://knowledge.wharton.upenn.edu/article/making-the-most-of-public-private-partnerships/.
38. Goldstein & Cohen, supra note 1.
39. See Hovy, supra note 6, at 1–2.
40. Id. at 2.
since the public partner may have to compensate the private partner to make sure they are no better or worse off than they would have been had the Compensation Event not occurred.\textsuperscript{42} The private partner may additionally be entitled to relief from a reduction in availability payments, or extensions to deadlines they are contractually obligated to meet.\textsuperscript{43} Compensation Events may include—depending on the contract—a breach of the contract by the public partner, construction of a competing facility, changed work requirements by the public partner, or discriminatory legal changes.\textsuperscript{44}

PPP contracts often provide for “compensation payments” to be paid to the private partner if activity by the public partner negatively impacts demand and thus revenue, like when the public partner has to shut down public access to the asset.\textsuperscript{45} It may seem fair that the public partner would reimburse the private partner for the direct impact it has had on the risk assumed by the private partner. However, for assets that the public partner may need to close frequently, this burden can add up.\textsuperscript{46} Chicago lost a lawsuit to Morgan Stanley for $61 million in compensation payments per their lease for the city’s parking meters due to street closures for parades and fairs, as well as free disabled parking.\textsuperscript{47}

Extraordinary circumstances that are unforeseeable and beyond the control of the parties are referred to as \textit{force majeure} events.\textsuperscript{48} They may include natural events—such as earthquakes, floods, and other natural disasters—as well as political and other special events—such as terrorism, war, riots,

\begin{itemize}
\item \textsuperscript{42} Id. at 26–27.
\item \textsuperscript{45} Renn, supra note 9, at 9.
\item \textsuperscript{46} Id.
\item \textsuperscript{47} Donald Cohen & Stephanie Farmer, Why Chicago’s Botched Parking Meter Privatization Is Also Bad for the Environment, NEXT City (June 4, 2014), https://nextcity.org/daily/entry/infrastructure-projects-p3-contracts-chicago-parking.
\end{itemize}
or nuclear contamination. The risk of force majeure events is usually allocated to the public partner, since they own the asset and may be in a better position to manage the risk. Typical PPP contracts contain force majeure clauses that may provide the private partner relief from performance in the event of a force majeure event, may grant the private partner an extension in meeting a deadline, may require the public partner to continue paying availability payments to the private partner, despite performance, and, in the case of an extended event, may grant both parties the right to terminate the agreement.

### B. Risk Exposure for Private Partner

The private partner typically takes on responsibility for risks within its control, as well as those it is in the best position to mitigate. In a full DBFOM project, this would include planning and design, permits and approval, construction, workforce, operation and maintenance, financial/market, and private sector default. In many cases, the project is financed with both private money and public money, such as municipal bonds or federal funding, such as TIFIA and WIFIA. In that case, both partners would be at risk for any market fluctuations that could affect the project’s debt structure. The contract for the lease of Indiana’s I-90 for $3.8 billion fully as-

### Footnotes


50. FHWA Toll Guide, supra note 41, at 31; U.S. Conf. of Mayors Urban Water Council, Mayor’s Guide to Water and Wastewater Partnership Service Agreements: Terms and Conditions 13 (Richard F. Anderson ed., 2005) [hereinafter Water Council]. But see World Bank Checklist, supra note 48, at 2 (“However, in certain markets, such as the UK, the grantor may require the project company to bear a portion, or all, of the force majeure risk.”).


53. Sabol & Puente’s, supra note 5, at 7.

54. See supra Section II.B.

55. Sabol & Puente’s, supra note 5, at 7.
signed the financial risk to the private partner. The private partner financed the project through a risky debt structure that “hoped to exchange low debt service costs early on with higher costs later, and then eventually refinance...” After the Great Recession, their project debt increased to $6 billion, and ultimately the private partner filed bankruptcy.

C. Shared Risk Exposure

Risks not within the control of either party may be shared or allocated in the terms of the contract. Both parties typically share the political risk of devoting time and resources to planning a project that is not approved. This risk can be mitigated with laws that give local governments or government agencies full power to negotiate and enter into a PPP without requiring legislative approval.

D. Demand Risk

The question of which partner bears the risk for project demand depends upon the project’s payment structure. In projects where the private partner obtains revenue entirely through tolls or user fees, they are exposed to the risk that the project will not generate as much demand as projected. If the public partner has agreed to pay the private partner “availability payments”...

57. Id. The public partner may be exposed to risk if the bankruptcy occurs prior to completion of the project. PPP contracts often include provisions designating private partner bankruptcies as defaults that allow termination of the agreement. See FHWA Toll Guide, supra note 41, at 50–51. In the event of termination, the public partner would still have to compensate the private partner for the portion of the project that has been completed. See id. at 53–54.
60. Id. at 13.
61. “Developer receives the opportunity to earn a financial return commensurate with the risks it has assumed either through the receipt of Toll Revenues (on which the Developer takes both demand risk and toll collection revenue risk) or availability payments (on which the Developer takes appropriations risk).” FHWA Toll Guide, supra note 41, at 4.
62. Id.
ability payments” throughout the life of the project for keeping it available to the public and in good condition, the public partner faces risk exposure. Even if the project generates insufficient revenue to meet these guarantees, the public partner is contractually obligated to pay, and will therefore lose money if the demand does not meet projections.63

Traffic projections are notoriously difficult, which makes toll roads risky start-ups.64 The ability to shift demand risk onto the private partner makes PPPs an attractive structure for these projects.65 In the lease of Indiana’s I-90 toll road, the contract assigned the private partner the revenue generated by the toll, rather than availability payments from the state.66 Demand did not come close to projections, which was a major factor in the private consortium’s bankruptcy.67 However, since the state bore none of the risk, they were unaffected by the bankruptcy, and ultimately received the original $3.8 billion, as well as wider toll lanes, the installation of electronic toll collection, and road maintenance.68 After failures caused by less than projected traffic demand in this toll road amongst others, companies involved in these deals have been pushing for availability payments rather than tolls or fees in order to mitigate their risk exposure, which, “leaves the largest risk—traffic and revenue—with the state, aka the taxpayers.”69

Availability payments may be the best option for the public partner despite greater risk exposure in projects where the government has purposes other than profit maximization.70

The Virginia 495 Express Lanes was a mixed purpose project—the private partner wanted to maximize profit from the

65. Poole, supra note 64.
67. Id.
68. RENN, supra note 9, at 6–7.
69. Poole, supra note 64; Mildenberg, supra note 64.
70. SABOL & PUENTES, supra note 5, at 7.
tolls, while the government wanted to help the environment and fight congestion; to meet both partner’s goals, the government subsidizes the private partner for lost revenue resulting from high occupancy vehicles that are excused from tolls.\textsuperscript{71} The Port of Miami Tunnel project has been financed solely through availability payments because the local government’s primary purpose in building it was to divert Port of Miami traffic out of downtown to reduce congestion, and did not believe the Tunnel would accomplish that if tolled.\textsuperscript{72}

IV. PPPs and Fiscal Distress

A. PPPs as a Lifeline for Distressed Municipalities

The deteriorating state of American infrastructure has been widely documented—both by formal academic studies, and through stump speeches by Donald Trump.\textsuperscript{73} This attention is not all fake news—$3.6 trillion of spending would be required by 2020 to bring American infrastructure to acceptable levels.\textsuperscript{74} The amount of spending on infrastructure as a percentage of GDP has fallen from 1.5\% in 1980 to 0.6\% in 2015.\textsuperscript{75} Less investment during that time period means that roads and pipes have become older and more costly to repair or replace.\textsuperscript{76}

\textsuperscript{71} Id. at 7, 10.
\textsuperscript{72} Poole, supra note 64; Scott Blake, Port Tunnel Tolls Not a Dime, MIAMI TODAY (June 6, 2013), http://www.miamitodaynews.com/news/130606/story4.shtml.
\textsuperscript{73} Schlenzbank, Nunn & Nantz, supra note 2, at 3; Aria Bendix, 7 Infrastructure Myths Perpetuated by Donald Trump, CityLab (June 16, 2016), https://www.citylab.com/equity/2016/06/7-infrastructure-myths-espoused-by-donald-trump/486605/ (detailing facts and “alternative facts” regarding US infrastructure espoused by Donald Trump on the campaign trail).
\textsuperscript{74} James F. Spitto, Ann E. Acker & Laura E. Appleby, Municipalities In Distress? How State and Investors Deal with Local Government Financial Emergencies 7 (2d. ed. 2016) (citing an American Society of Civil Engineers estimate).
\textsuperscript{75} Schlenzbank, Nunn & Nantz, supra note 2, at 1.
\textsuperscript{76} Id.
1. **PPPs Could Help Finance Distressed Municipalities’ Necessary Infrastructure Maintenance**

Cities in fiscal distress are especially vulnerable to dilapidating infrastructure, due to deferring infrastructure maintenance to make up for budget shortfalls. In addition to severely cutting basic services like police and fire protection, local governments may seek to sell assets, or put off necessary repairs.\(^77\) The lack of public services and necessary infrastructure causes the residents and businesses that can to flee; the shrinking tax base then further exacerbates the troubles of the city left behind because it will not be able to raise revenue to provide these essential services and investments in infrastructure.\(^78\) These shrinking cities then also face unique problems due to blight and abandoned buildings that are a further challenge for public works and may complicate or delay infrastructure maintenance.\(^79\)

Maintaining infrastructure is necessary not only for keeping a city’s residents and businesses in place, but also stimulating the local economy.\(^80\) Every dollar spent on infrastructure improvements generates $1.92 of economic activity in the short term and $3.21 of economic activity over twenty years.\(^81\) The economic activity and jobs generated by public investment lead to additional tax revenue so that local governments can afford to pay for basic services, pension liabilities, and debt without defaulting.\(^82\) Infrastructure improvements boost economic activity most in industries closely related to the improvements: transportation infrastructure improvements espe-

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78. Spiotto, Acker & Appleby, *supra* note 74, at 56 (describing this phenomenon as epitomized by Detroit in the second half of the 20th century).


80. See Schazenrach, Nunn & Nantz, *supra* note 2, at 5 (describing several studies finding correlations between infrastructure investment and productivity growth).


82. Spiotto, Acker & Appleby, *supra* note 74, at 32.
cially benefit vehicle-heavy industries. Studies also suggest there may be a higher rate of return associated with maintenance and improvement of existing transportation infrastructure, rather than with construction of new roads and highways.

Growing interest in PPPs to finance these infrastructure improvements rather than traditional debt financing has been attributed to the “ballooning” amount of debt held by municipalities. Although cities and taxpayers will still have to pay for the project eventually, PPPs allow projects to be totally or partially financed by equity rather than debt. This may be preferable as large amounts of debt may increase borrowing costs, make further debt issuances unappealing to the public and/or officials, and possibly preclude further borrowing due to statutory debt limits.

2. PPPs and Value for Money

PPPs may not be the lowest cost option for project financing, but they may deliver more value for money than other options. Built-in monitoring mechanisms in addition to government oversight or contractual provisions incentivize companies to design projects conducive to long-term savings. Companies responsible for multiple phases of a project have less incentive to skimp on quality: a company is less likely to use cheaper materials that will break down quickly and require substantial maintenance if that company is also responsible for maintaining the project for decades. Likewise, a company that stands to profit from future tolls is likely to construct a high-quality road so that more people will choose to use it. In addition to long-term savings through decreased energy usage,
lower maintenance costs, and enhanced resiliency, if demand
is shifted, taxpayers are not at risk that the project will take
longer or be more expensive than originally estimated.90

Proponents of privatization argue that no accountability
controls are necessary to ensure long-term efficient service de-

90. SABOL & PUENTES, supra note 5, at 11.

91. Ellen Dannin, Red Tape or Accountability: Privatization, Publicization,
and Public Values, 15 CORNELL J.L. & PUB. POL’Y 111, 117–19 (2005); Jody
Freeman, Extending Public Law Norms Through Privatization, 116 HARV. L. REV.
1285, 1297–98 (2003) (“[Public agencies] are not profit-maximizing entities
disciplined by competition and the possibility of bankruptcy, and so will tend
to be both less innovative and more wasteful. Because of differences of struc-
ture, organization, and institutional culture, private firms are thought to be
capable of providing the same or higher-quality services at lower cost than
can public agencies.”).

92. See Dannin, supra note 91, at 118–19.

93. Freeman, supra note 91, at 1300–01.

94. See id. at 1345; Simon Domberger & Paul Jensen, Contracting Out by the
Public Sector: Theory, Evidence, Prospects, 13 OXFORD REV. ECON. POL’Y 67, 71
(1997); Oliver Hart, Andrei Shleifer & Robert W. Vishny, The Proper Scope of
ture of PPPs may solve this problem by eliminating the incentive to cut costs at the expense of quality. Although responsibility for multiple phases of a project may encourage private actors to provide quality from the beginning, due to the noticeable absence of competition, additional accountability provisions in either the contract or in the state’s authorizing legal framework may be advisable to ensure the private parties in PPPs are adequately held accountable for delivering services efficiently for the length of the contract.95

Setting clear minimum quality requirements in the agreement is one method for providing accountability. For example, a water treatment PPP could specify guidelines for water testing so that the private partner will be required to regularly test its water and ensure that it meets relevant safety requirements. Even though the private partner is a monopolistic provider and residents will have to make do with the water that it provides, requiring testing will ensure that the private partner will not be incentivized to skimp on quality to maximize profits because doing so will result in a penalty. In addition, the looming prospect of water testing should force providers to make necessary repairs and improvements, unlike towns that have fallen behind on infrastructure maintenance because there is no one in the near future holding them accountable. Another way of ensuring accountability is to require providers to spend a set amount money to adequately repair and improve water treatment infrastructure; it would be unreasonable for the private partner to spend that money inefficiently if they are on the hook for providing a desired level of quality at the end.

3. PPPs Can Provide Distressed Municipalities with Much-Needed Cash—Which Should Be Used Responsibly

PPPs are frequently structured to include a lump sum payment to the public partner at the project’s start. Some municipalities choose to use this payment to pay off existing debt, which can increase its credit rating and drive down costs asso-

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95. This is especially important where pure profit-maximizing behavior on the part of private parties is hostile to the public agency’s goal of ensuring democratic values, especially where vulnerable populations are involved (e.g., prisons).
ciated with borrowing for other projects. Municipalities may also use this payment to fund other infrastructure projects to stimulate economic activity. However, PPPs that are just designed as stopgap measures to cover current debts or prop up spending are unlikely to succeed.

B. Potential for Exploitation

Some people automatically oppose deals in which the government contracts out public services to private companies. A sentiment exists that the government, and by extension taxpayers, will end up with a bad deal, or the private company will hike up the price demanded for its service once the ink dries. Fiscally distressed municipalities may rush into deals to make a quick buck to cover a current budget deficit, neglecting the deal’s future implications on the town’s finances. These towns and their residents are likely to be more adversely affected by the negative outcomes of a bad deal.

1. Case Study: Chicago Parking Meters

The Chicago parking meter deal shows elements of each of these kinds of exploitation. Chicago was in dire straits in 2008 due to the emerging financial crisis. After experiencing PPP success with the lease of the Chicago Skyway Toll Bridge, Mayor Daley proposed leasing all of Chicago’s parking meters to a consortium led by Morgan Stanley for seventy-five years. Crafted behind closed doors, the 512-page agreement was released three days before the Chicago City Council voted on it. The City Council spent only one hour debating the deal before rubber-stamping the lease with a 40-to-5 vote. The following year, the Inspector General issued a report finding

97. RENN, supra note 9, at 9.
98. Making the Most of Public–Private Partnerships, supra note 37.
99. Rowey, supra note 77.
100. RENN, supra note 9, at 5.
102. RENN, supra note 9, at 8.
that the parking meters were probably worth double the $1.16 billion payment Chicago had received.\textsuperscript{103}

Parking rates in some areas of the city immediately doubled.\textsuperscript{104} The city has since lost a lawsuit to Morgan Stanley for $61 million in compensation payments for removing parking meters from the road for construction or festivals, as well as for providing free disabled parking.\textsuperscript{105} Chicago has already spent the balance of the $1.16 lump sum on trying to plug budget deficits, but the city is still doing poorly financially, has lost a valuable revenue stream, and has to continue compensating Morgan Stanley for using the streets as it wishes.\textsuperscript{106}

Indianapolis followed in Chicago’s footsteps and leased its parking meters to a private consortium in 2011. Apparently learning from Chicago’s lessons, Indianapolis crafted a somewhat improved deal for its taxpayers.\textsuperscript{107} Under the terms of the deal, Indianapolis agreed to a fifty-year lease, with a $20 million upfront payment, but continued to retain rights to revenue sharing—receiving 30\% of any yearly profit up to $7 million and 60\% of any profits exceeding that.\textsuperscript{108} Rates initially doubled for their parking meters as well, but in the future they must only increase along with the CPI.\textsuperscript{109} Indianapolis also agreed to pay compensation payment for closing meters for street cleaning, and for replacing them with new electric charging spaces, but that only amounted to $270,000 in 2016.\textsuperscript{110}

2. \textit{Risk of “One-Time Revenues”}

A basic assumption of budgeting is that recurring revenues should pay for recurring operating expenses, and one-time revenues should only be used to pay for one-time expenses. This includes instituting important reforms whose savings will not be felt for years, or paying for infrastructure projects, whose benefits will be felt for the life of the pro-

\begin{thebibliography}{11}
\bibitem{103} \textit{Id.} at 6.
\bibitem{104} \textit{Id.}
\bibitem{105} Cohen & Farmer, \textit{supra} note 47.
\bibitem{106} \textit{RENN}, \textit{supra} note 9, at 9.
\bibitem{107} Tuohy, \textit{supra} note 15.
\bibitem{108} \textit{Id.}
\bibitem{109} \textit{Id.}
\bibitem{110} \textit{Id.}
\end{thebibliography}
It is not uncommon for local governments to use one-time revenues to pay for operating expenses or fiscal deficits to push “hard choices off into the future” and prop up spending. The Volcker Report found that fifteen states had limited reliance on one-time actions to close budget gaps, with fourteen relying on them even more so; the Volcker Report also found that states are more likely to resort to these measures during times of fiscal stress, even though that is when they are ultimately most harmful. For example, from 2003 to 2004, New York issued bonds secured by future payments owed to the state from a settlement against tobacco companies. Rather than using this injection of money to achieve an important policy objective, or continuing to receive the revenue stream in the future, New York used it to cover its current spending.

State or local officials looking for a one-time injection of cash to cover spending or deficits may look to sell or lease out infrastructure assets to private partners. However, when governments sacrifice future revenue streams for a one-time payment, and then use it to cover recurring expenditures, rather than a one-time expense, such as infrastructure investment, they have violated a rule of budgeting, and likely made a bad deal. Professor Julie Roin argues that these one-time payments are nothing more than camouflaged debt transactions if there is no additional gain in efficiency. Structuring debt this way allows officials to give current taxpaying voters lower taxes or additional government services without any potential stigma from issuing more debt. Residents will prefer debt—or PPPs that are effectively debt—to taxes even if the borrowed money is used ineffectively because they capture the

112. Ravitch, supra note 111, at 369.
113. Volcker All., supra note 111, at 14–19.
114. Ravitch, supra note 111, at 369.
115. Id.
116. See Anderson, supra note 77, at 1157–58.
117. Ravitch, supra note 111, at 369; Renn, supra note 9, at 9.
119. Id.
benefits and pass the costs onto future residents.\textsuperscript{120} Elected officials will be incentivized to deliver these "costless" benefits in order to garner popularity and future electoral success.\textsuperscript{121} Masking borrowing with privatization in this manner results in a hybrid with significantly reduced transparency and accountability.\textsuperscript{122}

These measures are particularly problematic where they impair a significant future revenue stream.\textsuperscript{123} Chicago traditionally earned $16 to $17 million annually from its parking meters; it planned to replace this revenue by replenishing its general fund from a long-term reserve fund established out of its upfront payment.\textsuperscript{124} However, local officials exhausted most of that fund paying for budget deficits, so it will only be able to contribute $2.5 million annually, leaving Chicago deprived of a significant amount of revenue for the duration of the lease.\textsuperscript{125} Indianapolis’s parking meter deal partially avoids this trap by retaining the right to part of the parking meter revenue throughout the lease.\textsuperscript{126} Although neither the city nor the private partner are making as much money as they expected due to faulty demand projections, Indianapolis will not be completely deprived of its future revenue stream, helping the city cover the compensation payments due.\textsuperscript{127} Indiana’s I-90 toll road was a breakeven operation with $200 million debt outstanding before it was leased out in 2006, so the state will not feel the loss of revenue from the tolls.\textsuperscript{128}

When one-time payments are received for asset leases, they should be used wisely. Spending these payments on infrastructure projects elsewhere in the city or state is more beneficial than blowing it on spending or servicing debts because it

\textsuperscript{120} Clayton P. Gillette, \textit{Direct Democracy and Debt}, 13 \textit{Contemp. Legal Issues} 365, 391 (2004). However, the more the cost of the debt is capitalized into current residents’ property values, the more their incentives will be aligned with future residents. \textit{See id. at 391–92; Nadav Shoked, Debt Limits’ End, 102 Iowa L. Rev. 1239, 1271–72 (2017).}

\textsuperscript{121} \textit{Id. at 2029.}

\textsuperscript{122} \textit{Id.}

\textsuperscript{123} \textit{Id.}

\textsuperscript{124} \textit{Id.}

\textsuperscript{125} \textit{Id.}

\textsuperscript{126} Tuohy, \textit{supra} note 15.

\textsuperscript{127} \textit{Id.}

\textsuperscript{128} \textit{Id.}
will stimulate more economic activity in the long run.\textsuperscript{129} Indiana used most of the $3.85 billion it received for I-90 on its Major Moves highway program, set aside $500 million in a Next Generation Trust Fund to maintain road and bridge capacity in the long term, and gave additional money to local governments to fund infrastructure payments.\textsuperscript{130}

The Chicago deal could be construed as Morgan Stanley taking advantage of a cash-strapped Chicago during the Great Recession by only paying half of the parking meters’ true value.\textsuperscript{131} However, there may be a greater risk that local officials will exploit future taxpayers by leasing off assets with future revenue streams in order to cover current costs. States could hinder such exploitation by statutorily requiring that municipalities forming long-term lease agreements provide representation, in the form of outside counsel or an independent oversight agency’s counsel, for future taxpayers. Although a lawyer with clients that are merely hypothetical could be a less effective advocate, this could give future taxpayers a seat at the table for deals that will ultimately affect them.\textsuperscript{132} The future taxpayers’ representative could then require adequate protections—such as provisions setting aside much of the upfront payment as future reserves to make up for future lost revenue,\textsuperscript{133} retaining the rights to a portion of toll proceeds, or requiring that the upfront payment be used for other specified infrastructure projects—in exchange for her “clients’” necessary approval. This allows the future taxpayers’ representative, working with the public and private partners, to tailor the protective provisions to the specifics of the deal, which would allow a more flexible approach than a statutory mandate that deals always be structured in a certain way.

3. \textit{Lack of Transparency}

The Chicago parking meter lease spells out the perils of a lack of transparency. The deal was approved without sufficient time for the councilors to even read the 512-page agreement,

\begin{itemize}
\item \textsuperscript{129} Spiotto, Acker & Appleby, \textit{ supra} note 74, at 31.
\item \textsuperscript{130} Renn, \textit{ supra} note 9, at 9.
\item \textsuperscript{131} Id. at 6.
\item \textsuperscript{132} It would be important to ensure that this representative is truly independent from the other parties so that they cannot be captured.
\item \textsuperscript{133} For a discussion of Professor Julie Roin’s suggestion, see \textit{ supra} Section IV.B.2.
\end{itemize}
let alone give the public any opportunity for meaningful political participation. If the city councilors, the general public, or an independent agency, such as the Inspector General, had the opportunity to review the terms of the deal, someone may have caught the $1.2 billion deal the city was offering Morgan Stanley before it was too late. Instead, Chicago’s Office of the Chief Financial Officer failed to provide city councilors with the parking meters’ valuation, because it had not calculated that figure. Since the Mayor and other officials had already decided to lease Chicago’s parking meters to cover their deficit, the Office of the Chief Financial Officer just evaluated whether it was the best deal available, while failing to consider whether it was even a good deal. Chicago’s financial condition at the time of the deal, coupled with its subsequent use of the funds to paper over budget deficits at the very least gives the appearance that the deal was hurried through, without sufficient transparency or political process, due to the city’s desperate position. This opaque and rushed process then allowed Morgan Stanley to take advantage of Chicago, which ended up with a very bad deal.

The Indianapolis parking meter deal shows some of the benefits that come with greater transparency. The deal as originally proposed consisted of a $35 million upfront payment with 20% profit sharing on the first $8.4 million annually, and 55% of any excess profits. The city council pushed the mayor to bargain for a better deal, and they ended up with a deal less skewed towards exchanging all future revenue for a lump sum. Now, they will have continuing profits to cover any requisite compensation payments. The original plan also would have required residents to pay for parking until 11 pm, which the revised plan scaled back to 9 pm.

Indianapolis city councilwoman Janice McHenry said that the city was in a tough fiscal spot, and would not have been

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134. RENN, supra note 9, at 8.
135. Id. at 4.
137. Id. at 4.
139. Id.
140. Id.
able to make the necessary technology upgrades to the parking meters.\textsuperscript{141} However, the city bargained for infrastructure improvements, and has ultimately used the upfront payment to pay for other necessary infrastructure repairs.\textsuperscript{142} Perhaps the different financial needs and planned purposes for the money put Indianapolis in a less desperate position, and afforded it more time to evaluate the deal and bargain for an improved one.

Indiana’s I-90 toll road also benefitted from the two months the legislature had to evaluate the agreement thoughtfully and for heated public debate to occur.\textsuperscript{143} Governor Daniels fought hard to get the deal passed in order to fund his Major Moves highway program, rather than to pay off a state deficit.\textsuperscript{144} No problematic provisions were ultimately spotted in the agreement during the vetting process, and the contract has functioned well since due to favorable risk allocation for Indiana, despite the private partner’s bankruptcy.\textsuperscript{145} More transparency and public participation also helps to avoid public perception of the project as illegitimate or crooked.\textsuperscript{146} Although Indiana’s toll road still has critics, they do not question its legitimacy, as the Chicago parking meter deal’s critics do.\textsuperscript{147} In Nassau County, New York, United Water talked to local environmental interest groups for two years before finalizing a deal; despite last minute opposition from outside environmental groups, the local groups and residents still backed the deal because they had participated in its formation and believed the terms were favorable.\textsuperscript{148}

4. “Price-Gouging” of Resident Consumers

One fear associated with privatization and PPPs is that if the government entity yields the ability to set the toll or user

\textsuperscript{141} Id.
\textsuperscript{142} Aaron M. Renn, Renn: Toll Road Lease Worked; Parking Meters Didn’t, IndStar (July 9, 2016), https://www.indystar.com/story/opinion/columnists/2016/07/09/renn-toll-road-lease-worked-parking-meters/86901938/.
\textsuperscript{143} RENN, supra note 9, at 8.
\textsuperscript{144} Id. at 6.
\textsuperscript{145} Id. at 8.
\textsuperscript{146} Id.
\textsuperscript{147} Id. (“The rushed approval process created a public perception that the parking-meter deal was illegitimate, if not crooked. While many in Indiana disapproved of the toll-road deal, no one questions its legitimacy.”)
\textsuperscript{148} Making the Most of Public–Private Partnerships, supra note 37.
fee, the private partner will hike the rate up significantly. This problem may be exacerbated in fiscally distressed municipalities for two reasons. First, residents left behind in a distressed municipality are much more likely to be insolvent themselves.\textsuperscript{149} Mobile residents and capital leave cities once they are no longer able to provide services they desire; combined with the effects of white-flight and suburbanization, distressed cities shrink and end up with a far more impoverished population.\textsuperscript{150} The pain caused by higher tolls or water bills will be more palpable to the new population.

In 2012, Bayonne, New Jersey, leased their water treatment system to private investors, guaranteeing availability payments for the next forty years, in exchange for $150 million upfront and $2.5 million annually in infrastructure repairs for a system that desperately needed it.\textsuperscript{151} An analysis done by the \textit{New York Times} in 2016 revealed that Bayonne had increased resident’s water bills by 28\% in order to meet the revenue guarantee they had promised their private partners, which was a larger increase than in comparable towns.\textsuperscript{152} The financial stress this caused is evident in the increase in residents that fell behind on water bills and, as a result, had liens placed on their homes: this number increased significantly from 200 in 2012 to 465 in 2015.\textsuperscript{153}

Second, distressed towns may be more vulnerable to accepting unfavorable contracts, for reasons discussed above.\textsuperscript{154} In Bayonne, where rates have risen significantly, they bargained for $150 million upfront, which they used to pay off $100 million of old debts.\textsuperscript{155} Local officials planned to use the remaining upfront payment to keep residents’ water rates frozen for four years, rather than the two provided for in the contract.\textsuperscript{156} However, a new mayor decided to use the earmarked money for property tax relief. As a result, water rates were

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{149} Andersen, \textit{supra} note 77, at 1137.
\item \textsuperscript{150} \textit{Id.} at 1140, 1210.
\item \textsuperscript{151} Ivory, Protess & Palmer, \textit{supra} note 96.
\item \textsuperscript{152} \textit{Id.}
\item \textsuperscript{153} \textit{Id.}
\item \textsuperscript{154} See \textit{supra} Section IV.B.3.
\item \textsuperscript{155} Ivory, Protess & Palmer, \textit{supra} note 96.
\item \textsuperscript{156} \textit{Id.}
\end{enumerate}
\end{footnotesize}
hiked up to cover the guarantee, revealing the problematic nature of the availability payments.\textsuperscript{157}

Rate increases may alternatively be thought of as a product of long-term mismanagement, which is common in distressed municipalities. Rich Henning, a spokesperson for Suez, the water company involved in the Bayonne deal, said that, “Bayonne had chronically underinvested in their water and sewer infrastructure, which has certainly contributed to rate increases during the past few years.”\textsuperscript{158} In Rialto, California, water rates increased by 68\%, after the city leased their water infrastructure to a private partner for thirty years.\textsuperscript{159} Table Rock, a private equity firm involved in the Rialto deal, claimed that “rates were artificially low after the city had declined to raise them for about a decade.”\textsuperscript{160}

Megan Matson, a partner at Table Rock, told the \textit{New York Times}, “Keeping rates down may sound like the ultimate righteous good for ratepayers, but the truth is, not if you’re failing to provide basic care and maintenance.”\textsuperscript{161} Rialto had been struggling financially for over a decade, experiencing a near default in the early 2000s and a hard hit by the Great Recession.\textsuperscript{162} One casualty of this fiscal distress was the city’s water infrastructure; maintenance and improvements had been deferred for years.\textsuperscript{163} This is not an uncommon pattern in cities struggling to balance budgets, and a significant cause of the U.S.’s problem with decaying infrastructure.\textsuperscript{164}

Rialto’s water utility’s issue was compounded by contamination from a nearby closed plant, which made water processing more complicated and expensive, and had the potential to give rise to a public health concern.\textsuperscript{165} The city of Flint’s water crisis sprung from similar circumstances. Flint, Michigan, had been plagued by fiscal woes for years, as evidenced by the city

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{157} Id.
\item \textsuperscript{158} Id.
\item \textsuperscript{159} Id. \textsc{sabol \& puentes}, supra note 5, at 2, 8
\item \textsuperscript{160} Ivory, Protess \& Palmer, supra note 96.
\item \textsuperscript{161} Id.
\item \textsuperscript{162} \textsc{sabol \& puentes}, supra note 5, at 9.
\item \textsuperscript{163} Id.
\item \textsuperscript{164} \textsc{schanzenzbach, nunn \& nantz}, supra note 2, at 8.
\item \textsuperscript{165} \textsc{sabol \& puentes}, supra note 5, at 9.
\end{enumerate}
\end{footnotesize}
being put in state receivership from 2011 to 2015.\textsuperscript{166} Flint had struggled to pay for necessary repairs, deferred maintenance on its deteriorating water infrastructure, and then, in an attempt to cut costs, switched to water from the Flint River.\textsuperscript{167} Flint’s water system could not treat the water adequately, and lead contamination found in the water caused a public health crisis.\textsuperscript{168}

Therefore, increases experienced by resident consumers may not be the result of an exploitative deal made with a private entity, but rather years of mismanagement and deferred maintenance leaving underfunded systems in desperate need of improvement. Even if the rate increases are not intentionally exploitative, they still place a heavy burden on low-income residents, such as the Bayonne residents who had liens placed on their houses after being unable to pay their new water bill. It seems unfair to cause residents to incur financial distress over such a basic necessity, but there are no good alternatives. Financing system maintenance and improvements traditionally financed through bond issuances just defers inevitable rate increases or raised taxes. Raising taxes to put a larger share of the burden on wealthier residents who are able to bear it will likely just exacerbate the problem by driving those residents out of town and further shrinking the tax base. Ultimately, current residents must pay for the necessary fixes, and financial distress for some residents may be a better outcome than a public health crisis.

However, PPP contracts can and should mitigate the potential for rate increases—particularly in situations where the increase serves not to meet a public need, but maximize private profits. In Rialto, California, the contract allows Rialto Water Services (“RWS”), the private entity running the water utility, to collect monthly revenue from residents, which may be increased on an annual basis with formula based rate adjustments to pay for the $42 million in capital improvements.

\textsuperscript{168} Bosman, Davey & Smith, supra note 166.
RWS was required to make in the first five years of the deal.\textsuperscript{169} The lease of Indiana’s I-90 toll road provided for an initial toll increase of 72\%, followed by an annual increase that was capped at the greater of: 2\%, or the rate of inflation, or the rate of increase in per-capita GDP.\textsuperscript{170} This rate increase was in exchange for an upfront payment of $3.8 billion that helped the state pay off existing debt on the road, maintain and improve infrastructure throughout the state, including its "Major Moves" highway program, and put money in the state’s reserve fund.\textsuperscript{171} However, this contractual provision is receiving a fresh round of criticism after rates for EZ-Pass users, which the state had discounted for the past decade, more than doubled to catch up with the rate increases for users paying in cash.\textsuperscript{172}

V. SUCCESSFUL PPPS

If PPPs manage to avoid these “exploitative” pitfalls, they can become beneficial tools for states and cities to invest in infrastructure investments. To capitalize on these arrangements, officials should favor deals that shift risk onto the private partner—such as construction time overrun risk, demand risk, and competition risk—in exchange for a smaller upfront payment. The state can insure that its municipalities do not use this structure unwisely by restricting the legal framework for authorized PPPs to the subset that would be most advantageous to the public.

A. Structural Factors

Certain assets or project structures have a better chance of delivering PPPs that are beneficial to the public.\textsuperscript{173} Officials should seek to take advantage of the structure’s inherent risk-

\begin{footnotes}
\item[170] Renn, supra note 9, at 6.
\item[171] Id. at 9.
\item[173] See Renn, supra note 9, at 13.
\end{footnotes}
shifting benefits by selecting projects suited to the same firm overseeing multiple phases, and payment structures that shift demand risk onto the private partner. Officials should also seek to minimize negative externalities and costs by choosing overdetermined assets that they are not depending on for future revenue streams.\footnote{See id. at 10–13 (describing “overdetermined” assets as assets like toll roads or hospitals that cannot easily be converted for use as something else).}

1. **Risk Shifting**

   The more phases of a PPP overseen by a private firm, the greater risk the firm assumes. In a full DBFOM project, this would include the risk originating from designing, building, financing, operating, and maintaining the project, whereas a design-build project only includes risk originating from the design and build phases.\footnote{Sabol & Puentes, supra note 5, at 6–7.} Design-build projects may or may not be thought of as real PPPs. They include a private partner assuming responsibility for multiple phases of a project, but do not include the hallmark decades long lease. Municipalities usually finance these projects through the sale of bonds, and then allow firms to bid for the project.\footnote{Making the Most of Public-Private Partnerships, supra note 37.} Adding more phases to the project is the best way to make a PPP worthwhile, through minimizing the amount of risk the public partner is exposed to throughout the life of the project, which protects it from any hiccups that occur along the way.

   The more phases a private partner oversees in a project, the stronger the agreement functions as a monitoring mechanism that aligns the incentives of the private partner more closely with those of the public partner, and induces them to put more value into early phases of the project, so they can reap the benefits and avoid additional costs later.\footnote{Schanzenbach, Nunn & Nantz, supra note 2, at 9; Sabol & Puentes, supra note 5, at 22.} In both Chicago and Indianapolis’s parking meter deals, the consortia leasing the meters made necessary improvements to them.\footnote{Tuohy, supra note 15 (Indianapolis); Renn, supra note 9, at 6 (Chicago).} It follows that they would seek to make these improvements well so that they do not have to repair them as frequently during their respective seventy-five and fifty-year
leases. Additionally, the more technologically savvy and user friendly they make the meters, the more revenue they will likely generate. However, these projects necessarily capture less benefits of risk shifting than a longer project, which would incentivize the private partner to optimize the design of the parking meters, the planned locations, and the original installations.179 From this perspective, it may be impossible to net as much of a benefit leasing out existing assets as from authorizing new projects as PPPs from the ground up.180

Officials should normally only enter into PPPs with a toll payment structure, rather than one in which they must make availability payments to the private partner.181 Since demand projections are rather unreliable, the public partner could find itself making availability payments that far exceed revenues, especially when paired with compensation payments. The private partner, which is usually more experienced and sophisticated in negotiating these deals, may be better positioned to know relevant information regarding the project’s risk, including demand risk.182 Although private parties seem to be increasingly demanding availability payment structures these days, officials should avoid them unless it is essential to the nature of the project.183

One critique of using a toll system instead of availability payments is that the private actors will sharply increase tolls to maximize profit, which hurts resident consumers. However, some toll increases may be necessary to fund vital maintenance, and contracts can provide for managed and fair rate increases.184 Additionally, states can regulate what rate-setting provisions contracts must contain.185 To ensure that rate increases are fair, contracts should require that the rates are calculated to provide the requisite amount of funding for infra-

179. See supra Section III.B.
180. Contra Schanzenbach, Nunn & Nantz, supra note 2, at 6 (finding that in the United States there may be higher returns from repairing and maintaining current projects than building entirely new ones).
181. But see supra Section IV.B.4 (discussing times when availability payments may be preferable).
183. See Poole, supra note 64.
184. See supra Section IV.B.4.
185. See supra Section II.A (recognizing legislation in twenty-nine states, D.C., and Puerto Rico addresses tolling and rate-setting authority; nine states, D.C., and Puerto Rico specify how and when rates can be changed).
structure maintenance. If the amount the private partner is required to spend on maintenance and repair is defined in the contract, then the contract should also specify that rates may be increased in order to generate that much funding over the maintenance period. If the amount the private partner must pay for maintenance is not specified, then the contract should delegate oversight of rate setting to the public partner or an advisory board to ensure that the private partner is not artificially inflating the amount required for maintenance with frivolous improvements in order to increase the rate.

2. Minimizing Costs

Costs arise when a government cannot respond to changing needs and conditions over a decades long lease. Leasing assets that could have multiple uses exacerbates this problem, because the government risks being unable to alter them even if a new use would be more advantageous to the public due to changing circumstances. If a PPP contract provides for compensation payments if the government closes the asset, then leasing an asset that must be closed frequently—such as parking meters for street maintenance or parades—may be problematic.

Toll roads and water treatment systems are “overdetermined”—it is less likely that the government would choose to make changes to these assets because their form cannot be changed; so there is less opportunity cost to losing that option. However, even overdetermined assets will likely face changing circumstances during the life of a long PPP that will require flexible government responses. However, there are fewer events that necessitate interfering with these assets, so the government is less likely to incur frequent compensation payments. Indiana had to pay compensation payments to

186. RENN, supra note 9, at 10–13; see, e.g., Tuohy, supra note 15 (explaining that Indianapolis had to compensate a private partner upon replacing parking meters with charging stations for electric cars).
187. See, e.g., Tuohy, supra note 15. But see infra Section V.B.2 (advocating against the use of compensation payment provisions).
188. RENN, supra note 9, at 10.
189. See id.
the concessionaire of I-90 when it waived tolls so that residents could escape from a flood faster.190

Officials should be wary of leasing out assets that will generate future revenue streams that the municipality depends upon. Although cash-strapped governments may be tempted by the prospect of a big upfront payment that can be used to cover current costs, this will unfairly eliminate a future revenue stream that rightfully belongs to future residents.191 This would not be problematic if the payment was preserved to supplement lost future revenue streams, but upfront payments are often misused.192 One way to avoid this is to lease off assets that do not generate important revenue, such as Indiana’s I-90 toll road; since the road was a breakeven operation, its leasing did not hurt the state financially.193

The mayors involved in the Chicago parking meter deal and the Bayonne water deal both intended to earmark money from the upfront payment to use in the future in lieu of the missing revenue streams; however, in both cases, the earmarked money was ultimately used to cover current deficits.194 Professor Julie Roin suggested a solution to this problem: “State statutes should require that governments place in escrow funds sufficient to generate an income stream equal to the net taxes or fees alienated, or rental obligations created, under any contractual relationship in which the government receives large, up-front cash transfers.”195 Officials will still be encouraged to enter into PPPs that create efficiency gains because they can spend money saved by lower costs of performance or increased revenue, but will not enter into disadvantageous deals for the big payday.196 Moreover, this solution protects future residents by keeping the future revenue streams

190. Goldstein & Cohen, supra note 1. But see discussion infra Section V.B.2 (discussing the problematic nature of compensation payments during emergencies).
191. See supra Section IV.B.2.
192. See RENN, supra note 9, at 9 (discussing Chicago using almost all of the payment it was given for the lease of its parking meters to cover debts); Ivory, Protess & Palmer, supra note 96 (discussing Bayonne, NJ’s new mayor, using an upfront payment for the lease of its water system to provide property tax relief, rather than to keep water rates frozen).
193. RENN, supra note 9, at 9.
194. Id; Ivory, Protess & Palmer, supra note 96.
195. Roin, supra note 118, at 2030.
196. Id.
Similarly, a state statute could require municipalities to appoint a representative for future taxpayers’ to ensure that the deal does not burden them unfairly. This would allow more flexibility to deal with situations like the Indiana toll road where the government was not truly losing out on future revenue streams, since the toll road had been breakeven, and the upfront payment was most productively spent on improving infrastructure elsewhere in the state. Roin’s escrow fund idea could be incorporated as a suggested provision for the representative to use in certain situations.

Another way to offset the harm caused by selling a future revenue stream is to sell only a portion of it. Revenue sharing provisions in PPP contracts can minimize the harm of selling future revenue streams; even if current officials blow the upfront payment covering current costs or debts, future governments will still have some source of revenue flowing in, and assuming the private partner caused some efficiency gain, the public partner will capture some of that gain. Indianapolis’s parking meter deal is an example of revenue sharing: under the contract, Indianapolis will receive 30% of any yearly profit up to $7 million and 60% of any profits exceeding that. Although they are not receiving as much revenue as projected—since the demand projections were faulty—this deal is considered superior to Chicago’s since they still have some amount of revenue coming in, which can be partially used to offset compensation payments.

**B. Legal Factors and Reforms**

However, local officials’ incentives may lead them to stray from optimal PPP structures. Should they seek to negotiate shortsighted deals to cover budget deficits or agree to deals where they retain the majority of the risk, state intervention may be necessary to tie their hands. The legal framework created by the state determines what assets may be chosen for projects, and what provisions may or must be included in the contract, so the state has the power to restrict official’s project choices.

197. Id.
198. See supra Section IV.B.2.
199. Tuohy, supra note 15.
200. See id.
201. See supra Section IV.B.2.
1. Non-Compete Prohibitions

Some contracts have non-compete provisions barring the government from dampening demand for the project by constructing alternate options or making improvements to existing alternatives. Non-competes can be problematic because they restrict governments from making changes to infrastructure to protect public safety, improve transportation, reduce traffic congestion, and promote environmental goals by reducing pollution. Since the duration of PPPs is typically a few decades, non-compete provisions restrict governments from responding flexibly to changing needs, problems, and technologies. California had to spend years in court and millions of dollars to regain their full rights to California State Road 91 so they could make necessary transportation infrastructure improvements they were barred from making during the life of the PPP due to its non-compete provision. One potential reason these provisions exist may be that private partners would be reluctant to enter into risky, long-term deals without assurances like non-compete provisions, and compensation payment provisions. However, officials may make the terms of the project less risky in order to drive up the amount of the upfront payment.

Nine states, D.C., and Puerto Rico prohibit non-compete provisions in their authorizing frameworks. However, these prohibitions may not be absolute; Texas allows contracts to require the public partner to provide the private partner with revenue losses attributable to competition from their new project in some circumstances. Furthermore, states may not have the power to contract away their police power to legislate for the public good or to control, repair, and maintain public streets and roads, which would render such provisions unconstitutional. Professor Matthew Titolo views this as an imper-

203. See Goldstein & Cohen, supra note 1.
204. See id.
206. See PULA, supra note 17, at 30.
208. Titolo, supra note 202, at 683.
missible exchange of sovereignty for the cash the governments receive upfront.\textsuperscript{209} This is exacerbated by the fact that governments will have to pay private partners when they need to exercise sovereignty, as in the case of compensation payments.\textsuperscript{210}

States PPP authorizing frameworks should include non-compete prohibitions, such as Texas' that prevent non-competes that would bar states from exercising police power to ensure public safety, and allow governments more flexibility in transforming their infrastructure. This would allow local officials to sometimes use narrowly tailored non-compete provisions to make deals more enticing to potential private partners, but limits the harmful long-term effects; these narrowly tailored non-compete provisions are also more likely to be enforceable.

2. Compensation Payments

Compensation payments are similar to non-compete provisions in that they protect private parties from the risk that government activity will reduce demand. These can be problematic because governments can rack up large bills closing assets for necessary maintenance and other activities. They become even more egregious when they prohibit the government from protecting public safety by responding to maintenance needs and emergencies.\textsuperscript{211} Compensation payment requirements can raise the same constitutional questions as non-compete provisions when they prevent states from exercising their police power to protect the public good; this may make both of these provisions unenforceable.\textsuperscript{212}

\textsuperscript{209} Id. at 633 ("Each of these provisions requires the government to exchange some quantum of sovereign power for up-front cash payments desperately needed to cover short-term budget gaps—a need all the more acute in the aftermath of the financial and real estate crises.").

\textsuperscript{210} See id. at 638.

\textsuperscript{211} See Ellen Dannin, \textit{Crumbling Infrastructure, Crumbling Democracy: Infrastructure Privatization Contracts and Their Effects on State and Local Governance}, 6 NW. J.L. & SOC. POL’Y 47, 58–60 (2011) (discussing repercussions of compensation payment clauses on emergency responding, such as delays or less effective response to try to minimize effect on the toll road, or a cash-strapped town being forced to decide between a big compensation payment it cannot afford and responding to an emergency); \textit{see also} Goldstein & Cohen, \textit{supra} note 1 (discussing Indiana owing almost $450,000 for waiving tolls for flood evacuations).

\textsuperscript{212} See Titolo, \textit{supra} note 202, at 638.
Private actors can account for risks like these by adjusting the upfront payment and doing proper due diligence. As such, it is likely that private actors will still enter into these deals, but officials will receive a smaller upfront payment. States’ authorizing frameworks should prohibit compensation payments to some degree, because it will not bar local governments from finding willing PPP partners, but will induce them to make deals that are more beneficial in the long run.

3. Term Length

Limiting term length is another way states have tried to make PPPs more beneficial. Sixteen states, D.C., and Puerto Rico have legislation that limit the term length for PPP agreements. One reason behind this is that longer the lease is, the more likely times will change, and the public partner will need to react, rather than being locked into an agreement; it follows that the longer the lease, the more potential that the public partner will have to go through the costly process of breaking it.

One reason behind the long life of PPP projects in the United States may be favorable tax treatment given to asset leases long enough to be treated as sales. U.S. PPP lengths seem potentially unnecessary when compared to shorter European PPPs. Shorter PPPs can “lessen a whole host of problems, including accuracy of predictions, impingement on democratic processes, and locked-in, obsolescent infrastructure.”

However, it would be difficult to draw a line precisely to avoid the negative implications of a long-term lease, while still capturing the benefits. An alternative to regulating PPP term lengths may be contracts that provide for mandatory renegotiation after a period of time to ensure that the deal can respond to changing circumstances.

213. Dannin, supra note 211, at 60.
214. See Pula, supra note 17, at 29–30 (comparing term limits ranging from thirty-five years to ninety-nine years).
215. See Dannin, supra note 211, at 67.
216. Id. at 92.
217. Roin, supra note 118, at 2027 (“A longer-term contract may be necessary to ensure that the private actor has the incentive to do its part of the bargain in the way that most benefits the public.”).
4. Transparency and Accountability Requirements

Government transparency and accountability requirements have become crucial to the democratic process for the U.S. government. However, some PPPs have avoided such stringent procedural requirement, and ended up worse off for it.219 Although twenty-two states, DC, and Puerto Rico provide opportunities for public comment, public hearings, or other public participation, some states limit the voices they hear when making these decisions.220 Public participation is especially important because officials may decide that privatization is necessary to improve infrastructure or fill budget holes, without considering options that may be less politically palatable.221

Chicago’s Inspector General, after reviewing the failed parking meter deal, recommended the city require a sixty-day review period before accepting bids to (1) receive an independent analysis of the deal’s costs and benefits, (2) hold public hearings, involving speakers from the independent analysts, outside experts, and critics, and (3) have meaningful City Council debates.222 States should follow this model of requiring decision-makers to meaningfully and publicly consider the terms of PPPs, so they cannot rush through bad deals for improper reasons. It is also necessary to publicize terms of a PPP and allow the public meaningful opportunities to ensure that public welfare is not being overlooked in the agreement.223

5. Additional Laws

In addition to the substantive and procedural regulations discussed above, other legal interventions may be advisable to ensure that appropriately structured deals are implemented.224 One way to do this is to make sure that the agree-

219. See supra Section IV.B.3 (discussing the lack of transparency in Chicago’s disastrous parking meter deal).
220. See Dannin, supra note 91, at 133–34.
221. See Dannin, supra note 211, at 74 (“Public officials may say there are no alternatives because of public resistance to taxes.”); CHICAGO IGO REPORT, supra note 136, at 4.
222. See CHICAGO IGO REPORTS, supra note 136, at 7–8; see infra Section V.B.5 (discussing what body would be most appropriate to evaluate PPP deals).
223. See Dannin, supra note 211, at 82, 94–95.
224. See supra Section V.A.
ments that are approved have been vetted properly. A common method states have used to try to ensure successful PPPs is through requiring legislative approval. One critique of this requirement is that requiring legislative approval increases the political risk that the project may not come to fruition, which may discourage private partners from participating or allow them to use that risk to bargain for more favorable terms. Another critique is that state legislatures or other entities will not have the necessary expertise to adequately vet these deals. Professor Ellen Dannin argues that only the federal government has the resources necessary to employ experts able to evaluate whether PPPs will deliver better value for money, so they should have an agency dedicated to that.

It is necessary to have some critical analysis of the benefits and costs of a potential PPP to make sure the project is worthwhile. Although the federal government has not created a body to evaluate PPPs, nine states, D.C., and Puerto Rico have created advisory bodies for PPPs, and fourteen states, D.C., and Puerto Rico require cost-benefit, comparative, or other analyses for PPP approval. It is important to have clear parameters for cost-benefit analyses and an expert body evaluating them so that benefits are projected accurately and all costs are taken into consideration.

States could also ensure that PPPs are appropriately structured by passing substantive laws requiring certain structures. States should authorize full DBFOM deals since they are the ideal PPP, but prohibiting, for example, OM deals, would restrict official’s flexibility and prevent them from using PPPs for

225. See Pula, supra note 17, at 36 (finding that twenty-six states and Puerto Rico require state legislature approval, review or other involvement; twenty-four states, D.C. and Puerto Rico require approval, review or other involvement by other state, local or federal entities).
226. Sabo & Puentes, supra note 5, at 13; see Edwards, Hafer & Reidy, supra note 16, at 176 (stating that National Conference of State Legislature’s PPP best practices guideline does not require final, post-agreement, approval by the state legislative bodies).
227. See Dannin, supra note 211, at 93–95.
228. See id. at 94–95. Dannin specifically advocates putting an Office of Public Benefit in the Federal Highway Administration, as proposed in a bill before the House of Representatives in 2009 that was not enacted. Id.
229. See Pula, supra note 17, at 70.
230. Dannin, supra note 211, at 89 (discussing the importance of identifying all costs properly).
existing assets. Additionally, an ideal PPP shifts demand risk to the private partner by using a toll payment structure, but some circumstances make an availability payment structure more beneficial. Such a need for flexibility makes expert advisory boards, cost-benefit analysis requirements, or future taxpayer representatives more attractive than substantive regulations. However, I believe that incorporating Professor Julie Roin’s suggestion—keeping the portion of the upfront payment equal to the future revenue stream in an escrow fund—would be a valuable way to keep officials in distressed municipalities from digging their towns into deeper financial holes after immediately spending the upfront payment.

**Conclusion**

PPPs can be a beneficial structure for infrastructure asset deals because they allow parties to shift risk and put private partners in charge of multiple phases of a project, thereby incentivizing the private partner to take more care during the length of the project. Additionally, they offer governments with crumbling infrastructure that are hesitant to issue more debt or raise taxes a much-needed opportunity to revitalize their infrastructure.

However, many officials may be looking to PPPs as a way to “sell” assets for a quick cash infusion to cover debts, which results in the long-term loss of an important revenue stream. This problem can be exacerbated when the contract is extremely long, contains non-compete provisions, requires compensation payments, or utilizes an availability payment structure. Because of this, local governments, or independent bodies advising them, should be required to carefully weigh the benefits and costs of a project to ensure PPPs deliver the most value for their money.

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231. See *supra* Section III.D.
232. See *supra* Section V.A.2; Roin, *supra* note 118, at 2030.