Renegotiations & Bankruptcies in U.S. surface transportation P3s

Lisardo Bolaños
Center for Transportation Public-Private Partnership Policy
George Mason University
http://p3policy.gmu.edu/

IRF Public Private Partnership Workshop
Washington D.C., April 2018

Why is the topic important?

- Renegotiations of P3 contracts raise concerns over opportunism
  - Millions of dollars involved in renegotiations
  - Private sector & public sector opportunism
  - See: Guasch (2004), Guasch et al. (2007), Gifford et al. (2014)

- Bankruptcies are also a concern over the viability of P3s
  - Billions of dollars involved in bankruptcies
  - See roads in Spain and in Mexico. Also the metro in London
  - See: Vining and Boardman (2008), Gifford et al. (mimeo)

- Both topics (renegotiations and bankruptcies) are connected

Main lessons from the U.S. Experience

- Institutional differences affect behavior
  - U.S. key institutional differences: capital markets & bankruptcy legislation (Ch. 11)
  - Renegotiations have imposed fewer costs on the public sector or citizens
  - Bankruptcy costs have mostly gone to the private sector (equity + bondholders)

- Some institutional elements have been imitated by other nations
  - Evolution of bankruptcy legislation was unique in the U.S.
  - Bankruptcy legislation has been imitated for P3 purposes in Spain & France

Presentation Outline

- U.S. transportation infrastructure P3 market
- A framework to understand renegotiations & bankruptcies
- P3 renegotiations & bankruptcies in the U.S.
- Discussion

U.S. Transportation Infrastructure P3 market

Recent Surface Transportation Projects

State	Road	Tunnel	Bridge	Commuter rail	Total
California	1				1
Colorado	2			1	3
Florida	2	1			3
Indiana	1		1		2
Maryland				1	1
NJ – NY			1		1
North Carolina	1				1
Ohio	1				1
Pennsylvania			1 project (500)		1
Texas	5	1			6
Virginia	2	1			3
TOTAL	**15**	**3**	**2+1**	**2**	**23**

Continental U.S. DBFOM, DBFM, Long-Term Lease (financial close 2008+)

Source: U.S. Federal Highway Administration Office of Innovative Program Delivery (retrieved: June 2016); Public Works Finance (retrieved: January 2016); different media sources

A framework to understand renegotiations & bankruptcies

Renegotiations and Bankruptcies

- It is important to acknowledge that bankruptcies and renegotiations are not intrinsically “bad”
- Renegotiations allow adaptation to a bad environment, common in private sector contracts
  - See: Rich and Tracy (2013); Tirole (1999); Saussier et al. (2009)
- Bankruptcies allow for resource reallocation away from sub-par firms or failed innovations
  - See: Hayek (2002); Becchetti et al. (2003)

Renegotiation Drivers

Opportunism

Renegotiation occurs **to extract rents**, taking advantage of the incompleteness of the contract

See: Guasch (2004)

Exogenous changes

Renegotiation occurs **to adapt to unexpected exogenous events** that affect benefits of participants

See: De Brux (2010)

Contract complexity

Renegotiation occurs **to adapt to unexpected complexities** of the project

See: Saussier et al. (2009)

Winner´s curse

Renegotiation occurs **to diminish the loses of the bid winner** when it had unrealizable expectations

See: Athias et al. (2009)

Those Drivers May Generate Other Results

Opportunism may generate

Contract complexity may generate

Exogenous changes may generate

Winner´s curse may generate

Renegotiations

Debt default

Bankruptcy

Buy-out

Gov. control

What are these Other Results?

Renegotiations

Modifications of the conditions of the P3 contractual agreements

Buy-out

SPV is acquired by a new owner with different skills and risk preferences

Gov. control

SPV does not fulfill contract responsibilities. Public sector can assume control of the asset

Bankruptcy or Foreclosure

Legal status of an entity that cannot repay its debt. The court may approve liquidation or debt relief.

Debt default

Inability to meet debt repayment obligations (interests and/or principal) when due.

Some P3 renegotiations & bankruptcies in the U.S.

Findings for Renegotiations

- Main drivers for renegotiations in the U.S. P3 highways
  - Exogenous shocks: Great Recession and policy response
  - Contract complexity: novelty, civil rights concerns, risk transfer
- What about other explanations?
  - Opportunism evidence is not clear-cut (except SR 91 by Caltrans)
  - Winner´s curse evidence may be deceiving (ITR)
- Why we are skeptical of opportunism against the public sector?
  - Bankruptcies do take place and wipe-out the equity owners

Findings for Bankruptcies

- Not all bankruptcy legislation is the same
  - Foreclosure favored opportunistic behavior

- Bankruptcy legislation differs across the Atlantic
  - Debt restructuring allows the business to continue (U.S.)
  - Liquidation prioritizes lender´s repayment (“classical” European legislation)

- Two institutions minimize the use of renegotiations and public sector risks
  - U.S. Chapter 11 & Active capital market purchasing the SPV

SR 91 Express Lanes (SR91)

Concessionaire	Level 3 Communications, Vinci Autoroute, & Granite Construction
Financial close	1993
Facility Open	1995
Revenue source	Toll
Contract type	DBFOM
Original cost (US$)	88.3 million (1990)
Constructed Length	10 miles (16.1km)
Bridge / Tunnels	No / No

Context & renegotiations

- Bill 680 [1989], allowed four P3 demonstration projects
- Express toll lane in the median of SR91
- Highly profitable project & non-compete clause while traffic demand was increasing
- 2003: **OCTA purchases the project** for $341.5M to eliminate non-compete clause, after attempts to breach the contract by the public sector

Dulles Greenway (DG)

Concessionaire	Shenandoah Group, Kellogg Brown & Root
Financial close	1993
Facility Open	1995
Revenue source	Toll
Contract type	DBFOM
Original cost (US$)	350 million (1993)
Constructed Length	14 miles (22.5km)
Bridge / Tunnels	Yes / No

Context & renegotiations

- Private sector bought the land and the right-of-way
- Highway Corporation Act [1988] allows DG to operate as a toll road
- Traffic volume lower-than-expected. **Default risk** led to **renegotiations**
- Speed limits , tolls, additional investment and increased concession period (1995-2004, 2013)
- Macquarie Infrastructure Group (MIG) **buys** project

Indiana Toll Road (ITR)

Concessionaire	Cintra & Macquarie
Financial close	2006
Operation began:	2006
Revenue source	Toll
Contract type	DBFOM + OM
Original cost (US$)	3,778 million (2006)
Constructed Length	10 miles (16 km) to build & 150 miles (240 km) to maintain
Bridge / Tunnels	No / No

Context & renegotiations

- Four bidders
  - Cintra & Macquarie: $3.8 billion
  - Itinere I S.A.: $2.5 billion
  - Indiana Road Co LLC: $2.8 billion
  - Indiana TRP LLC: $1.8 billion
- **Default risk** led to **renegotiations**: Toll freezes, reimbursements, fewer investment obligations
  - 2014: SPV filed for **bankruptcy** – interest rate swap (Great Recession policy response)
- 2015: IFM Global Infrastructure Fund **purchases** the SPV for $5.7 billion

Elizabeth River Crossings

Concessionaire	Skanska & Macquiare
Financial close	2012
Facility Open	Expected 2017
Revenue source	Toll
Contract type	DBFOM
Original cost (US$)	2,089 million (2012)
Constructed Length	2.2 miles (3.5km)
Bridge / Tunnels	Yes / Yes

Context & renegotiations

- Very expensive tunnels
- Toll opposition as existing tunnels fund the construction of the other tunnels
- Low income and race in the political mix
- VDOT sued and taken to the Virginia Supreme Court – ruled in favor of VDOT
- **Renegotiations**: tolls delayed, slashed & eliminated after reimbursements (2012-2015)
- A recent renegotiation to cut toll rates for low-income people in the area

Camino Colombia Bypass

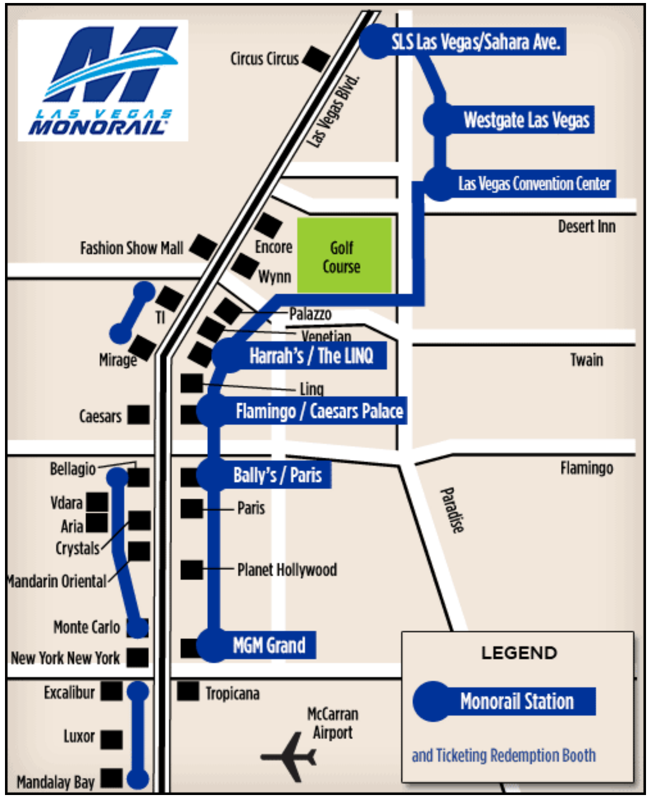
Operation began:	2000
Revenue source	Tolls
Contract type	DBFOM
Original cost	$85 million
Project attribute	21-mile road
Year bankruptcy filed	2004
Bankruptcy filer	John Hancock Life Insurance and New York Life Insurance
Law	Texas Property Code Title 5

In brief: causes & aftermath of bankruptcy

- Cause: Demand lower than projected
- Actions: **Foreclosure**. Sold in auction for $12 million to John Hancock Financial Services Inc.
- New owner **holds-up** TxDOT and gets $20 million for selling the road
- Road is currently managed publicly by TxDOT

Las Vegas Monorail

Operation began:	2000
Revenue source	Fare
Contract type	DB/Equip+O&M
Original cost	$650 million
Project attribute	3.9-mile elevated dual-guideway monorail
Year bankruptcy filed	2012
Bankruptcy filer	Las Vegas Monorail Corp.
Law	U.S. Bankruptcy Code Chapter 11



In brief: causes & aftermath of bankruptcy

- Cause:
  - Demand lower than projected (projections over-estimated demand)
  - No-skin-in-the-game (63-20 nonprofit corporation)
- Actions: **Chapter 11** reorganization plan approved in May 2012.
- Debt reduced down to $13 million.
- After 7 years, interest to borrow $110 to continue expansion

Discussion

How Can Renegotiations Be Used Wisely?

- Renegotiations can help avoid problems
  - Dulles Greenway did not go bankrupt
  - Opposition to Elizabeth River Crossings diminished
- Renegotiations can be useful
  - Condition to sell Pocahontas Parkway
  - Condition to sell South Bay Expressway
- Renegotiations do not “solve” all design problems
  - Indiana Toll Road went bankrupt
- Renegotiations should be considered as an alternative
  - To change the scope of the non-compete clause of SR91
  - To change SBX project scope and terms to avoid delays, costs and litigations
  - To avoid conflict escalation and litigation, as in ERC.

What if Renegotiations are Avoided?

- Buy-outs are an option
  - It diminishes the monopoly power of the incumbent private operator
  - It is an alternative to inconvenient renegotiations and bankruptcies
    - But you need an active capital market for this or a transparent P3 program in place

- Bankruptcy is an option
  - The threat of bankruptcy is real in the U.S. with concessionaire & creditors absorbing most of the financial loses
  - No government debt-guarantees
  - Usually only federal government is affected via TIFIA loans
  - However, TIFIA´s “spring lien” was useful to protect the public sector

How to Deal with Unavoidable Bankruptcies?

- Debt restructuring legislation is key
    - It allows the project to continue providing services to citizens
    - It minimizes threats from the concessionaire, remember Camino-Colombia
- Avoid debt guarantees
    - A cost of subsidies are easier to quantify than the risk of default
- Officials should be willing to let concessionaire absorb losses
    - U.S. exception: Indiana´s I-69
- Officials should also let bondholders absorb losses
    - Las Vegas Monorail: bondholders lost 98% of the value after bankruptcy
    - Indiana´s I-69: bondholders will be compensated after state took over control of the project

Lenders should pay attention to potential opportunistic behavior from equity holders

- Opportunistic behavior may take place against banks and bondholders

- Two warning signs
  - Is the P3 organized via a non-profit entity?
  - Does the P3 have a convoluted governance structure?

- Allegations have been made for two cases
  - Las Vegas Monorail in Las Vegas
  - SH 130 segments 5&6 in Texas

Renegotiations & Bankruptcies in U.S. surface transportation P3s

Lisardo Bolaños
Center for Transportation Public-Private Partnership Policy
George Mason University
http://p3policy.gmu.edu/

IRF Public Private Partnership Workshop
Washington D.C., April 2018