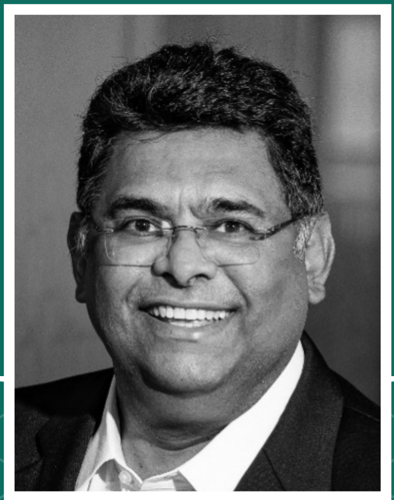
Q2 INFLUENCE: RESPONSIBILITY



Tipping the Scales of Risks and Rewards on P3 Megaprojects

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Walter P Moore CEO Dilip Choudhuri calls for P3 change

Current State

Public-Private-Partnership (P3) financed megaproject procurement is broken. A recent study that examined 224 projects (with contract values between $250 million and $2 billion) concluded that P3 projects are among the biggest money losers for contractors. According to published reports, these losses are driving large, sophisticated contractors like Skanska, Granite and Flour to reduce P3 pursuits or exit the P3 market altogether. If this trend continues, the pool of prospective P3 bidders will become ever shallower, hurting everyone.

The Problem

On a P3 megaproject, risks exist for all participants during all three project phases: development, construction and operation. This essay focuses on the early stages of the P3 project and key contract aspects.

One of the most serious things ailing P3 is the growing disconnect between risks and rewards. The concessionaire (typically a P3 consortium) is attempting to flow down risks related to financing, the ability to reach financial close, site and regulatory risks, political and inflation risks (to name a few) onto the construction and design team. In successful arrangements, these risks should remain with the parties having the authority and capability to do something about them.

For P3 projects to work, the concessionaire must at least bear risks they are best suited to mitigate if they want to reap the benefits of ownership. Proper risk allocation — and balance — are essential.

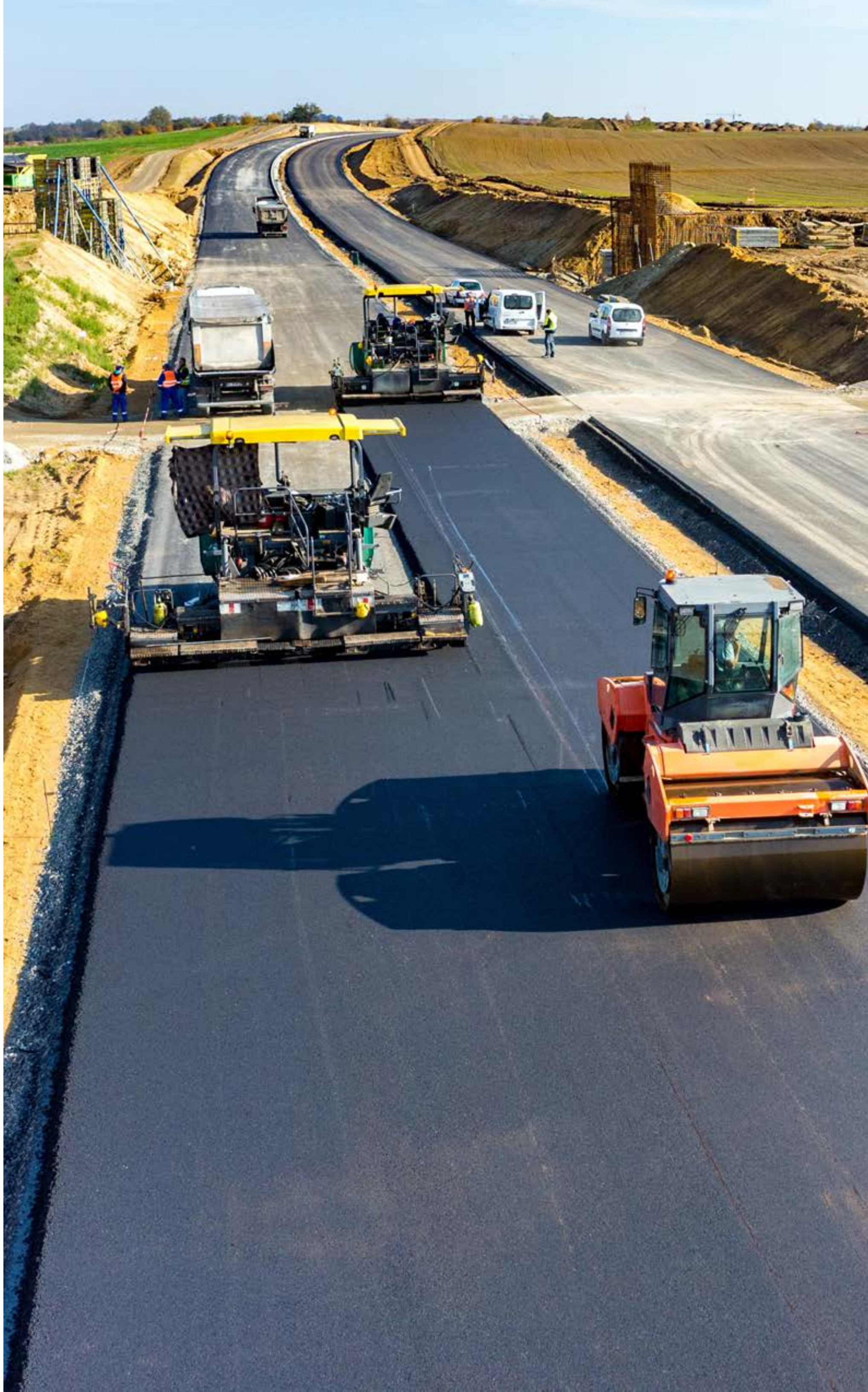
P3 megaprojects are generally conducted under extremely tight schedules. Material prices and labor costs are constantly escalating and the resultant final project costs often exceed initial budgets. But the reasons why final project costs typically outstrip initial budgets are not remotely connected to what design and construction teams are tasked to do and have within their control. These kinds of project cost escalations always result in expensive litigation that wastes the time and energy of all concerned.

Project A

Take the example of a notional project, *Project A*, a multi-billion-dollar P3 project with transportation and building components on a brownfield site. To start with, in the US, there are no generally accepted industry risk management guidelines to protect the design and construction teams.

Five common themes are likely to be observed in the early stages of our notional P3 project, *Project A:*

1. Upstream agreements between the public entity and the concessionaire are highly complex, with little visibility to the design and construction team.
2. The selected concessionaire may not be fully capable of funding the project on their own because of the large project size. The design and construction team members have little knowledge of these dynamics.



3. Design teams may have to share design expertise and intellectual property without a contract or agreed upon terms or a commitment for full payment of early design efforts.
4. Design team proposals will, in most instances, not be signed. Teaming agreements will likely not be presented to the design team.
5. Insurance requirements from the P3 consortium/owner will flow down to the design and construction team.

This scenario for *Project A* affords little opportunity for teamwork, collaboration and transparency. Even if the entire design and construction team is fully aligned, there is a lack of collaboration between the P3 consortium and the design-build team, because they generally view the design and construction team as replaceable — essentially, a commodity.

Project A Solutions

- You could mitigate items 1 and 2 above with a full commitment toward greater transparency from the P3 consortium down to entire team of sub-consultants under a nondisclosure agreement.
- A basic early-stage teaming agreement that details scopes of work, fee and payment terms could mitigate items 3 and 4.
- A commitment to buy a Project Specific Policy (PSP) coupled with a limit of liability in the base contract could mitigate item 5.
- PSPs can provide professional liability coverage for the design team collectively and afford many other benefits. For example, PSPs have the advantage of providing the design team a joint defense. Unlike contingency funds or practice insurance, they can also provide a protected, primary fund source to compensate for contingencies arising from the inherent risks of P3 projects.
- Finally, PSPs may disincentivize or defer intra-design team disputes and litigation.

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Each of the above mitigation strategies is a major topic on its own. Each requires more deliberate discussion. The point is — there are better ways to solve P3 megaproject procurement issues than those in current industry practice.

Why is the Risk-Reward Allocation Broken?

The U.S. is relatively new to the P3 world compared to Europe, Canada and South America. Lessons from our prior U.S.-based domestic P3 projects have not been widely shared to educate the design and construction community of the existential threats that exist on P3 projects gone sour.

Another reason is that the design and construction community is not working together to push harder for change when faced with risk-reward misallocation on P3 financed projects.

In many cases, public agencies are not looking through the concessionaire's lens and want to control and influence all aspects of the design, as they would in the case of a traditionally procured project.

Long project durations and complexities build in great uncertainty in the development of early stage demands for a guaranteed maximum price. This results in disputes and decisions counter to the overall program intent and inhibit project success.

Setting Up P3s for Success: The Upside

We need to set P3 projects up for success. This can't wait. Our country and industry depend on it. Indeed, a recent ASCE report card gives the nation's infrastructure a pathetic C- grade. To change this letter grade to an A grade and to create a cycle of growth and prosperity depends on a viable P3 market sector. The P3 project sector has the irreplaceable potential to unlock capital and unleash abundant opportunities for the architecture, engineering and construction (AEC) industry — one whose talented professionals are ready and capable into the foreseeable future. We need the AEC industry to fix P3. We can do so by continuing to develop industry guidance and P3 benchmarks and by advocating for reconnection of P3 risks and rewards.

Dilip Choudhuri serves as the president/CEO of Walter P Moore, an international company of creative people who solve some of the world's most complex challenges for the built world. The firm was founded in 1931 and employs 800+ professionals across 23 U.S. office locations and six international locations. Dilip is a member of the board at Walter P Moore and leads the executive committee and the firm's strategy council. Dilip is a fellow of the Structural Engineering Institute of ASCE and serves on several professional, academic and nonprofit boards.