

P3 Update for California Transportation Projects: Appellate Decision Helps Pave Way for Current and Future Projects

by Philip J. Tandler and Paul C. Levin

The Presidio Parkway Project, California's first public-private partnership ("P3") to move forward under legislation enacted in 2009, is expected to proceed after a California appellate court denied a request to enjoin the project. Filed on August 8, the decision upheld a lower court ruling dismissing a claim that the project did not meet the requirements of California's P3 transportation authorization statute.¹ This is significant not only for the Presidio Parkway Project, but also because the legislation applicable to this project is the blueprint for structuring eight other pending transportation projects with a total estimated cost of \$25 billion.²

The ruling will allow the California Department of Transportation ("Caltrans") to apply tax revenues (as appropriated through the annual budgetary process), rather than toll revenues (which are dependent upon driver demand), to fund availability payments to be made under a contract with the concessionaire responsible for constructing and operating the project. The ruling also confirms that Caltrans is properly acting as the "responsible agency" under the enabling statute. Whether the appellate court ruling is the last word on the matter remains to be seen because it is still possible that the ruling could be appealed to the California Supreme Court. If appealed, however, it is not certain that the California Supreme Court would elect to review the ruling.

Background

The Presidio Parkway will replace Doyle Drive, the thoroughfare connecting San Francisco to the Golden Gate Bridge. Doyle Drive is structurally deficient and does not meet current highway safety or seismic

¹ Cal. Sts. & Hy. Code §143.

² California Public Infrastructure Advisory Commission, Emerging Project Pipeline, available at: <http://grovesite.com/page.asp?o=cabth&s=PIAC&p=383078&i=305336>

standards; this replacement project has been under consideration since 1998. The union representing Caltrans engineers and related professionals, Professional Engineers in California Government (“PECG”), filed suit in November 2010 seeking to prevent Caltrans from implementing the second phase of the project by effectively preventing the agency from entering into a contract with the concessionaire that would provide for availability payments funded by tax revenues.

Significance

PECG’s lawsuit challenging the Presidio Parkway Project argued that projects procured under California’s P3 transportation authorization statute must be funded by toll revenues. However, as structured, the proposed funding source for availability payments under the contract with the concessionaire would be fuel tax revenues. Using toll revenues as the funding source for availability payments, rather than fuel tax revenues, would impact both the concessionaire and its ability to obtain financing for the project because toll revenues are linked to demand uncertainty and collection risk. As is common in many P3 transportation projects, the Presidio Parkway Project was not structured to allocate these risks to the concessionaire. Rather, the project was structured to provide for the allocation of a dependent revenue source (fuel taxes) to fund availability payments.

Availability payments allow an owner (Caltrans) to transfer the risk of constructing, operating and maintaining a roadway or other P3 project to the concessionaire at an agreed-upon level of service. This structure also allows owners to reduce payments for periods in which the roadway is not operational or is not properly maintained. In order to be eligible for the full availability payment under the contract, the concessionaire is incentivized to meet the contractually agreed construction milestones, as well as certain levels of service. As an example, in the Presidio Parkway Project, the concessionaire is not eligible for availability payments until the roadway opens to the public and, among other requirements, the concessionaire must respond to emergencies and incidents on the roadway within ten minutes of notification and repair pot-holes of a stipulated size within 24 hours of notification.

Importantly, the predictability of a long-term revenue stream provided by an availability payment made by a credit-worthy entity allows concessionaires to finance the capital costs needed to construct a project. In the absence of such a revenue stream, most lenders would be unwilling to finance this type of project because ridership or toll collection risk would be allocated to the borrower (*i.e.*, the concessionaire).

The court’s decision allowing the project to proceed under an availability payment structure confirms that toll revenues are not a required funding source under the P3 transportation authorization statute. If the ruling is upheld, future projects procured under this statute should find it easier to attract project-specific debt financing than if toll revenues (and their associated risks) were required.

Summary of Specific Holdings

The court’s ruling contains three main holdings:

Legal Claims Challenging the Project

Under the authorizing statute, P3s must be funded only by tolls and user fees and the Presidio Parkway Project is not funded by either.

Court Holding & Significance

The enabling statute does not restrict funding for P3s to tolls and user fees. P3s may be funded by fuel tax revenues.

Legal Claims Challenging the Project

The statute authorizes P3s only for “supplemental” projects, but the Presidio Parkway replaces an existing road.

Caltrans did not meet the statutory requirements of a “responsible agency” in connection with the project.

Court Holding & Significance

Under the statute, “supplemental” projects include upgrades to existing transportation systems, including seismic and road safety improvements.

Caltrans met the requirements of a “responsible agency.” No changes to the nature of Caltrans’ involvement in the project are necessary.

Conclusion

It is important to recognize that P3 projects in California may be governed by different legal frameworks. For instance, the high speed rail project,³ construction of new court facilities⁴ and transportation projects are all authorized by separate statutes. The ruling discussed in this client alert is limited to the P3 transportation authorization statute.⁵ This ruling, as well as the progress to date on the Presidio Parkway Project, however, bodes well for future P3 transportation projects in California, including eight major roadwork projects across the state⁶ and expansion plans for the Los Angeles Metro system.⁷

If you have any questions about the content of this alert, please contact the Pillsbury attorney with whom you regularly work, or the authors below.

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³ Cal. Pub. Util. Code §185000 *et seq.*

⁴ Cal. Gov. Code §70371.5.

⁵ See note 1.

⁶ See note 2.

⁷ Los Angeles Metro, Public-Private Projects for Metro Transportation Projects, available at http://www.metro.net/projects/public_private_partnerships/

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