This document is scheduled to be published in the
Federal Register on 09/10/2014 and available online at
http://federalregister.gov/a/2014-21049, and on FDsys.gov

DEPARTMENT OF TRANSPORTATION **[4910-22-P]**

Federal Highway Administration

[Docket No. FHWA-2014-0006]

Final Core Toll Concessions Public-Private Partnership Model Contract Guide

AGENCY: Federal Highway Administration (FHWA), Department of Transportation (DOT).

ACTION: Notice.

SUMMARY: The Moving Ahead for Progress in the 21st Century Act (MAP-21) requires DOT and FHWA to develop public-private partnership (P3) transaction model contracts for the most popular type of P3s for transportation projects. Based on public input favoring an educational, rather than prescriptive, contract model, on February 6, 2014, FHWA published a draft of the Core Toll Concession Model Contract Guide (Guide) (Docket No. FHWA-2014-0006), requesting comments by March 10, 2014. The FHWA received a total of 133 public comments regarding different aspects of the Guide and of P3s in general. With this notice, FHWA publishes a revised Guide reflecting these comments. In coming months, FHWA will publish additional draft guides for public comment: an Addendum to the Core Toll Concession Model Contract Guide that will address additional contract provisions, and an Availability Payment Concession Model Contract Guide that will cover this popular type of P3 arrangement.

The revised Core Toll Concession Model Contract Guide can be found on the Docket (FHWA-2014-0006) and at the following link:

http://www.fhwa.dot.gov/ipd/pdfs/p3/model_p3_core_toll_concessions.pdf

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Comments Received and Addressed Regarding the Guide:

On February 6, 2014, FHWA published a draft of the Model P3 Core Toll Concession Contract Guide (Docket No. FHWA-2014-0006). The draft requested comments on each of the substantive topics discussed in the Guide. The FHWA received a total of 133 comments from multiple stakeholders regarding different aspects of the Guide and in varying degrees of detail. In particular, FHWA received 60 comments from the Texas Department of Transportation (TxDOT), 13 comments from Ernst & Young Infrastructure Advisors (Ernst & Young), 10 comments from Professional Engineers in California Government (PECG), 9 comments from the Drive Sunshine Institute, 6 comments from the Associated General Contractors of America, 5 comments from the Commonwealth of Virginia, 5 comments from the American Road & Transportation Builders Association (ARTBA), and 25 comments from private citizens.

A minority of comments addressed the desirability of P3s as a matter of public policy, while the majority of comments focused on the terms of the concession agreement described by the Guide (including terms relating to tolling regulation, benefit sharing,

supervening events, changes in equity interest, changes in law, defaults, early termination, and handback) without commenting on the desirability of P3s generally. The FHWA considered all of the comments it received on the Guide and revised the relevant sections of the Guide as described below. In addition, FHWA made clarifying revisions to certain sections of the Guide as noted below.

Response to Comments

Note: The comments below, as does the Guide itself, often refer to the "Department" – the public authority granting rights via a concession agreement. In all cases, this entity should be understood to be a State or local transportation agency, not the United States Department of Transportation.

Chapter 1: Introduction

1. The TxDOT commented that the concept of "demand risk" described in Section 1.1 of the Guide should be expanded to include toll collection risk; the term "revenue risk" captures both demand and toll collection risk.

The FHWA agreed with TxDOT's comment and has revised Section 1.1 accordingly.

Chapter 2: Tolling Regulation

2. The comments received on the Guide's review of tolling regulation generally related to the setting of tolls, the administration of toll collection, and the use of toll revenues in the context of a concession agreement.

The TxDOT commented that the Guide should more clearly explain that changes in User Classifications have potentially significant public policy implications and therefore the Department often retains broad discretion whether to approve

changes. The TxDOT also commented that the Guide should note that changes in User Classifications requested by a Developer can also affect future toll revenues and that toll concession agreements may contain provisions for adjusting the Department's revenue sharing if the change is projected to increase the Developer's revenues.

The FHWA agreed with TxDOT's comment and has revised the Guide accordingly.

3. Ernst & Young commented that the Guide should consider the amount by which tolls can be raised in a given year, particularly where the maximum allowable toll increase has not been made in prior years, and should include a discussion of the costs and benefits of a tolling strategy which maximizes revenue versus throughput.

The FHWA agreed with Ernst & Young's comments and has revised the Guide accordingly.

4. The TxDOT suggested that Footnote 1 of the Guide be deleted. The TxDOT disagreed with FHWA's suggestion in Footnote 1 that toll concession agreements for projects with an element of public financing might include provisions to allow lender rate covenants to control, such that toll rates may exceed the maximum toll rates specified in the toll concession agreement. The TxDOT noted that Footnote 1 cites Private Activity Bonds (PAB) as the type of financing where this may be appropriate but, according to TxDOT, including lender rate covenants on such terms is not accepted practice for PABs financings, which are public financings only in the sense that a public entity serves as a conduit issuer for the benefit of a

private Developer, and the Guide is directed at toll concessions with private concessionaires. Such provisions, TxDOT suggested, can undermine essential public policy that supports the toll rate regulation decisions of the State or local government, and could be abused in order to elevate private profit.

The FHWA agreed with TxDOT's comment and has revised the Guide accordingly.

5. The TxDOT additionally commented that the contract language set forth in the Guide's section on Tolling Regulation misleads the reader to think that giving the Developer sole discretion in setting and changing toll rates is the norm. The TxDOT noted that, in its experience, such discretion is the exception and not the norm. Accordingly, TxDOT suggested that the Guide include sample contract language that establishes maximum toll rates and terms for how the maximum may change over time.

The FHWA agreed with TxDOT's comment and has revised the Guide accordingly.

6. The TxDOT commented that, in certain instances, a regional tolling authority provides toll collection and administration rather than the Department because the regional authority may have a statutory right and obligation to provide tolling services for all tolled facilities. The TxDOT suggested that the Guide should therefore mention this potential circumstance and that the Guide should call for working out the terms of a tolling services agreement with such a tolling authority before proposal submission so that proposers know what pricing, terms and conditions to expect.

The FHWA agreed with TxDOT's comment and has revised the Guide accordingly.

7. The TxDOT suggested deleting the statement that the agreement with the tolling authority is "typically known as a 'Toll Enforcement and Violation Processing Services Agreement'." The TxDOT felt that the statement is not necessary and the term is not used across all jurisdictions. The TxDOT additionally suggested that the section also should state that such an agreement may be with the Department or may be directly with a regional tolling authority.

The FHWA agreed with TxDOT's comment and has revised the Guide accordingly.

8. The TxDOT commented that FHWA should revise the sample contract provision which implies that it is the Department that has the primary responsibility to coordinate with law enforcement agencies to bring to bear toll enforcement services. The TxDOT noted that, while toll concession agreements often provide for Department assistance to the Developer in arranging such law enforcement, they commonly state that the Developer is primarily responsible for coordinating with law enforcement agencies for toll enforcement.

The FHWA agreed with TxDOT's comment and has revised the Guide accordingly.

9. The ARTBA commented that the Guide should include additional discussion about issues surrounding the collection and enforcement of tolls, including the authority, responsibility and tools available to the Department and Developer in the collection and enforcement of tolls.

In response, FHWA notes that the Guide does address possible approaches in a general manner in Section 2.5.2. However, given that the rights and responsibilities of the Developer to enforce toll collection is highly dependent on applicable State and local laws, it is difficult to comment in great detail outside the context of a particular project and a particular State, and such discussion is outside the scope of the Guide.

10. The TxDOT and Ernst & Young provided related comments on the Guide's statement that "it is common for the uses of Toll Revenues in the Concession Agreement and flow of funds in Financing Documents to mirror each other." They suggested that the Guide overstates typical flow of funds provisions in toll concession agreements. They further commented that toll concession agreements tend to require first priority use for paying operating and maintenance expenses (including sums owing the Department) and lowest priority use for distributions to equity (after all other project costs are covered), but otherwise leave it to the lenders and Developer to determine the full order of priority for use of Toll Revenues. The TxDOT and Ernst & Young commented that the text should be revised accordingly.

The FHWA agreed with these comments from TxDOT and Ernst & Young and has revised the Guide accordingly.

11. The PECG commented that the Guide should include language requiring the Developer to use Toll Revenue to meet payment obligations to the Department, operating and maintenance expenses, taxes, debt service, and other costs, before making payments to equity.

Section 2.6 of the Guide includes these payment obligations in its discussion of provisions designed to prevent the Developer from diverting Toll Revenues for unauthorized purposes. The FHWA revised the Guide to note that a Department may prescribe a list of authorized uses of Toll Revenues, but recognizes that some Concession Agreements may leave the decision regarding the full order of priority of payment obligations to the Lenders and the Developer.

12. The PECG provided the following comment: the Guide should give the Department the right to suspend tolling in case of an emergency or for any other purpose, and the Developer should not be entitled to lost toll revenue due to such action by the Department.

The FHWA appreciates that Concession Agreements will often include provisions to this effect, and such provisions are expressly described in Section 2.7.1 of the Guide.

13. The PECG commented that the Guide should not provide the Developer with an entitlement to lost revenue if access to the project is impeded for a beneficial public purpose.

The FHWA notes that the Developer's right to compensation is limited to those matters defined as Compensation Events. The extent to which a Concession Agreement may provide a Compensation Event under these circumstances would typically be determined by the facts and circumstances relevant to the particular project, and to the extent that the Department is obliged to undertake certain obligations with respect to the Project (e.g. providing ongoing access) and does

not, such a failure constitutes a Compensation Event. The FHWA does not believe a change to the Guide is necessary.

14. The PECG commented that the Guide should not provide the Developer with an entitlement to lost revenue if toll collection is temporarily suspended to benefit or safeguard the public.

The FHWA appreciates that Concession Agreements will often include provisions to this effect, and such provisions are expressly described in Section 2.7.1 of the Guide.

15. The FHWA determined that it would be beneficial to users of the Guide to include a table setting forth toll rate restrictions and has included such table in Section 2.4.

Chapter 3: Benefit Sharing

The comments received on the Guide's review of benefit sharing generally related to requests to include a broader discussion on gross revenue-based sharing mechanisms and other types of benefit sharing in a refinancing context.

16. The TxDOT and Ernst & Young provided similar comments to the effect that the Guide should avoid prescribing one approach over another in relation to triggers for revenue sharing. Instead, they suggested that FHWA should consider including discussion of gross revenue-based sharing triggered by absolute revenues in addition to revenue sharing triggered by actual equity IRR. They also commented that the Guide should include a discussion of the challenges associated with using actual equity internal rate of return (IRR) as a trigger and guidance on how to manage toll concession windfalls.

The FHWA agreed with these comments from TxDOT and Ernst & Young and has revised the Guide accordingly.

17. Ernst & Young commented that FHWA should clearly highlight that in a properly structured P3 procurement, both equity and lenders are at risk and the public benefits from this fact. Ernst & Young also suggested that (a) FHWA consider whether the Guide should require lenders to share in refinancing gains, and (b) the discussion of sharing refinancing gains in the Guide should differentiate between gains from refinancing based on higher than expected or proven traffic versus market movement in interest rates.

This change was not incorporated as it was determined that this issue was already addressed by the Guide as a whole.

18. In Section 3.2.2, FHWA included a table setting forth bands and revenue payment percentages.

19. In Section 3.2.2, FHWA clarified the concept of "deferred amounts."

20. In the Glossary, FHWA added a definition for the term "caps and floors."

Chapter 4: Supervening Events

The comments received on the Guide's review of Supervening Events generally related to the scope of various types of Supervening Events, the considerations and rationale driving the allocation of risk under a Supervening Events regime, the compensation to be paid to the Developer in respect of a Supervening Event, and certain public policy concerns in respect to Supervening Events.

21. The TxDOT suggested that FHWA clarify that some Delay Events are also Compensation Events, and may affect both the cost and the schedule of a project.

They further suggested that Sections 4.1 and 4.3.3 should mention that Delay Events may allow a Developer to extend contractual deadlines and may provide a Developer with relief from the assessment of performance points or noncompliance points.

The FHWA agreed with TxDOT's comment and has revised the Guide accordingly.

22. The TxDOT suggested that the term Compensation Event should be expanded to include events that deliver value for money by allocating risk to the Department.

The FHWA agreed with TxDOT's comment and has revised the Guide accordingly.

23. The TxDOT commented that the sample definition of the term Compensation Event should include certain additional events, including: Department-caused delay; Department-ordered suspension of tolling; Department releases of hazardous materials; unreasonable, unjustified delay by permitting agencies in issuing key permits; utility owner delay; and differing site conditions.

The FHWA agreed with TxDOT's comment and has revised the Guide accordingly.

24. Ernst & Young commented that Departments should be mindful that there is a distinction between the cost of delays and lost revenue. They suggested that, with respect to lost revenue, the calculation options presented in the Guide should also contemplate the possibility of paying pre-determined, liquidated damages amounts, avoiding the need to re-open the financial model.

The FHWA acknowledges the distinction between delay costs and lost revenue. The proposed approach to calculating lost revenue is one that Departments may choose to consider after consultation with their financial advisors, but it has not been adopted in the U.S. to date and therefore has not been incorporated into the Guide. A change to the Guide is not necessary to address this comment.

25. The TxDOT suggested that the Guide reflect the fact that a toll concession agreement may include provisions which adjust compensation under the agreement based on the development of revenue-enhancing facilities which were not planned at the time the agreement was executed.

The FHWA agreed with TxDOT's comment and has revised the Guide accordingly.

26. Ernst & Young highlighted the importance of the Competing Facilities provisions, and noted that these merit significant policy consideration by a Department.

The FHWA agrees that these clauses should be carefully considered in light of the important public policy issues they raise and the Guide recommends that Departments do so in light of the facts and circumstances relevant to each individual project. A change to the Guide is not necessary to address this comment.

27. The PECG suggested that the Guide should not include a "non-compete" clause.

The FHWA acknowledges the important public policy issues raised by competing facilities clauses, and Section 4.3.2 of the Guide describes some of the reasons why Departments have chosen to include them in contracts for P3 projects. A change to the Guide is not necessary to address this comment.

28. The PECG suggested that a Department should not be required to pay the Developer if another government agency not within the Department's control engages a private entity to develop a project that affects demand for the Department's project.

The FHWA acknowledges the intra-governmental issues which may arise as a result of such provisions, and notes that Section 4.3.2 of the Guide suggests these risks be addressed by providing protection to the extent the Department has discretionary authority over facilities constructed by other governmental entities. Each project will present unique challenges in this regard, however. A change to the Guide is not necessary to address this comment.

29. The TxDOT commented that while the Guide states that Departments are likely to achieve optimal risk transfer regarding geotechnical, hazardous substance, utility, and endangered species risks by providing Compensation Event relief for unknown matters, this allocation varies considerably from project to project, and will depend upon particular project characteristics, the magnitude of the risk presented on the particular project, the degree of competition, and other factors. The TxDOT suggested that the Guide should indicate that optimal risk allocation for these risks depends on the attributes of each project and procurement.

The FHWA agreed with TxDOT's comment and has revised the Guide accordingly.

30. The TxDOT commented that while the text regarding Force Majeure Event termination in the Guide states that providing a termination right for extended Delay Events other than Force Majeure Events is contrary to international best

practice, it is common U.S. practice to include specified Delay Events in addition to Force Majeure Events in the determination of extended delay triggering a right to terminate. The TxDOT stated that the principle supporting such termination is that exigencies outside the control of the parties have conspired to frustrate the fundamental purpose of the transaction. Certain Delay Events in addition to Force Majeure Events fit within this principle and therefore should be validated in the text as well as the sample contract language.

The FHWA agreed with TxDOT's comment and has revised the Guide accordingly.

31. The TxDOT commented that the Guide should acknowledge that in relation to a Force Majeure or Delay Event, a contract may trigger termination rights based on a cumulative number of non-consecutive days of delay as an alternative to a specified number of consecutive days of delay.

The FHWA agreed with TxDOT's comment and has revised the Guide accordingly.

32. The TxDOT commented that the application of the "no better and no worse" principle is an oversimplification of the Supervening Events regime and FHWA should provide greater clarity regarding the application of this concept.

The FHWA agreed with TxDOT's comment and has revised the Guide accordingly.

33. The PECG suggested that the Guide should explicitly transfer all Force Majeure Event risk to the Developer, to avoid the potential costs associated with Force Majeure Events being borne by a Department.

This comment reflects a misunderstanding of the economic impact of transferring certain risks and the rationale for P3 procurements. Departments will not receive value for money if all risk of Force Majeure Events is transferred to the Developer given the tools available to Developers to mitigate the effects of such risks and the contingencies they would have to price if asked to take such risks. As Departments are familiar with this risk on non-P3 projects, value for money is typically optimized by retaining the financial risk associated with Force Majeure Events. A change to the Guide is not necessary to address this comment.

34. A private citizen expressed concern about the allocation of costs associated with earthquake damage to P3 projects.

The consequences of Force Majeure Events such as earthquakes are allocated pursuant to the Delay Event regime. The Developer will be given additional time to complete the work, but not compensation to pay the cost of repairing the loss as such costs can be insured against. This is described in Section 4.3.3 of the Guide.

35. The TxDOT commented that FHWA should expand its discussion of deductibles to highlight the differences between "aggregate" and "per occurrence" deductibles, and to provide information on the details, advantages and disadvantages of both. In addition, TxDOT commented that the Guide should state that deductibles usually do not apply to Compensation Events which are caused by or within the control of the Department.

The FHWA acknowledges that deductibles may be applied to Supervening Events in some Concession Agreements, and has revised the Guide to include a general discussion of deductibles. However, FHWA thinks that the value provided to the

Department from including deductibles can be overstated except in certain unique circumstances (such as where a Compensation Event is susceptible to numerous *de minimis* claims). As Departments should look to their advisors on a case-by-case basis for advice on when this is appropriate, FHWA believes that a more detailed discussion than the one provided is not necessary to be included in the Guide.

36. The TxDOT suggested that the Guide mention that market participants may elect to utilize an objective discount rate, such as the Developer's Equity IRR or weighted average cost of capital as indicated in the Base Case Financial Model, rather than calculating present value using an agreed risk adjusted discount rate. The FHWA acknowledges that there may be appropriate alternative means to discount the relevant sums and encourages Departments to seek advice from their financial advisors as to the appropriate method to use in a given circumstance.

37. The TxDOT commented that FHWA should revise the model provision regarding a Developer's obligation to obtain additional debt or equity following a Compensation Event. The proposed revision would reflect certain precedents which condition compensation on the Developer's ability to meet debt coverage ratios and require the Developer to use "diligent efforts" to obtain additional funds to cover the cost impacts of the Compensation Event.

The FHWA acknowledges that there are transactions in the market that make reference to debt service coverage ratios; however, the ultimate standard in such documents is whether or not the Developer is able to raise funding (which will include factors broader than the ability of the Developer to meet ratio tests). In

some jurisdictions the concept of "diligent efforts" is vague and may be read to suggest a level of effort that is synonymous with "best efforts." This standard would not be in the interest of the Department or the Developer, as it is traditionally interpreted to require a party to spend additional funds and do all things possible, even if not reasonable, to achieve the desired outcome. The Department's compensation sum would have to be increased to pay for the impact of such potentially unreasonable actions, which would not represent value for money. A change to the Guide is not necessary to address this comment.

38. The PECG commented that the list of events which constitute a Compensation Event should be limited to (i) a breach of the Concession Agreement by a Department, and (ii) the development or implementation of any change in the Work or technical requirements applicable to the Work that the Department has directed the Developer to perform pursuant to a Change Order or a directive letter pursuant to the Concession Agreement.

The proposed changes to the definition of Compensation Event are inconsistent with the allocation of risks on the basis of value for money. A change to the Guide is not necessary to address this comment.

39. Ernst & Young commented that FHWA should consider whether the Guide needs to include reference to the fragmentary network.

The FHWA believes this is a useful touch-stone for Departments to see, as it is a method that is familiar to them in the context of design-build contracting. A change to the Guide is not necessary to address this comment.

40. The TxDOT suggested that the discussion of toll concession agreements in the Guide should be expanded to include noncompliance events and points regimes, financial modeling, and the role of an independent engineer.

Financial modeling is discussed in the Guide, and noncompliance points and the role of the independent engineer will be addressed in the addendum. A change to the Guide is not necessary to address this comment.

41. The FHWA clarified the term "fragmentary network" as used in Section 4.4.2.

Chapter 5: Change in Equity Interests

The comments received on the Guide's handling of changes in equity interests generally related to the extent to which the Department should prohibit a change in equity interests, the qualifications to consider for approving a new owner, and related terminology.

42. The TxDOT commented that Section 5.1 should be revised to mention that, in addition to Developer experience with similar projects, a Department may value Developer experience which demonstrates ability to effectively manage all aspects of future work on a project.

The FHWA agreed with TxDOT's comment and has revised the Guide accordingly.

43. The TxDOT also commented that the Guide should acknowledge that (a) a change in control over an investor can have a significant effect on the management, staffing and funding of the investor and Developer, and (b) Department approval should be required for any changes in the vertical chain above the Developer. In addition, TxDOT noted that the concept of Change in Ownership should be

changed to Change in Control to reflect the impact of voting rights and other forms of control that may not be strictly linked to ownership.

The FHWA has revised the relevant footnote within the Guide to clarify that approval should be required for changes in the vertical chain between the entities that were evaluated and/or any parents of such entities that the Department considers important to the success of the project. However, FHWA disagrees that the term "Change in Control" better indicates the intent of these provisions than the term "Change in Ownership" since a change in ownership that does not affect a change in control may still have a material adverse effect on the Project, which these provisions are intended to prevent.

44. The TxDOT commented that the standard for Department approval of a Change in Ownership should be narrowed in light of certain precedent which uses a standard that assesses whether a potential owner has the resources, qualifications and experience to perform the Developer's obligations, and no conflict of interest with the Department exists.

In FHWA's view, the factors cited in this comment do not lead to a different result than the formulation described in the Guide, and in fact may restrict the Department's right to reject a change in ownership. While some Concession Agreements do cite these factors, the evaluation mechanism provided for in the Guide will require the Department to weigh all factors against one another, and the resulting determination will be substantially the same as asking whether the change will result in a material adverse effect. For these reasons, FHWA believes a change to the Guide is not necessary to address this comment.

45. The TxDOT also commented that the definition of Related Entity should include all entities upstream from the Equity Investors.

The FHWA has not made any changes in response to this comment because it is based on a misunderstanding of the entities that will constitute the Equity Investors.

Chapter 6: Change in Law

The comments received on the Guide's review of the issues surrounding change in law generally related to associated risk allocation and the scope of relevant terminology and contract language.

46. The TxDOT commented that the Guide should not emphasize foreseeability as a consideration in risk allocation in relation to a Change in Law, and instead should focus on value for money as the most relevant consideration in allocating risk in relation to a Change in Law.

In FHWA's view, the concept of foreseeability is not intended to go beyond changes in law that were foreseeable at the bid date based on draft legislation and bills. It is not intended to suggest that because changes in a particular category of law are inevitable at some point, they are foreseeable. The FHWA has revised the Guide to clarify this point.

47. The TxDOT further commented that the definition of Law should not include permits to avoid conflation with the definition of Governmental Approvals and, therefore, the definition of Law should be revised to provide greater specificity to the concept.

The FHWA has incorporated this comment into the Guide. Some Concession Agreements may treat changes in permits similarly to changes in law generally, though this will depend on the nature of the required permits and the jurisdiction of various Governmental Authorities in the context of each individual project. As a result, the reference to permits is bracketed in the example provision.

48. The PECG commented that the Guide should protect the Department from financial claims by a Developer adversely affected by a Change in Law promulgated by a legislature, which is not within the Department's control. In FHWA's view, the allocation of risk associated with changes in law is reflective of the relative ability of each of the parties to absorb the risks associated with changes and to mitigate against their respective effects. A change to the Guide is not necessary to address this comment.

Chapter 7: Defaults, Early Termination and Compensation

The comments received on the Guide's review of defaults, early termination, and related compensation generally related to the scope and nature of defaults covered by a Concession Agreement, the remedies exercisable by the parties following a default, the cure periods in respect of defaults, and the mechanisms for calculating (and valuing the components comprising) termination compensation.

49. The TxDOT suggested that the Guide include provisions which allow for termination due to (i) the failure or inability of the Developer to achieve financial close, with the measure of compensation depending on whether the failure is excused or not excused, and (ii) an adverse court ruling which prevents the Developer from continuing performance, with a measure of compensation similar

to the one provided following termination due to an extended Force Majeure Event.

The FHWA agreed with TxDOT's comment and has revised the Guide accordingly.

50. The TxDOT commented that the Guide should acknowledge that certain precedents do not include a limitation on set-off that prevents termination compensation being less than the outstanding project debt as a result of such set-off.

This comment has been incorporated into the Guide, although it should be noted that the limitation on set-off does not apply to circumstances where the termination arises due to a Developer Default. In those instances, full set-off is contemplated because the Lenders have the opportunity to step in and cure the Developer Default prior to termination.

51. The TxDOT commented that the cure period available following a monetary default under the Guide should be shorter than the cure period available following other types of material default. The TxDOT further suggested that the Guide should acknowledge that some Developers and lenders agree to cure period comity between Developer and lenders.

The suggestion that the Guide distinguish between payment defaults and other defaults has been incorporated into the Guide. Regarding cure period comity, a change to the Guide is not necessary because cure period comity is not the typical approach taken.

52. The TxDOT suggested that the Guide acknowledge that in certain precedent toll concession agreements, the Developer's termination rights are restricted to two types of Department Defaults: (i) uncured failure to pay a material sum to the Developer, and (ii) Department confiscation, condemnation, or appropriation of a material part of the Developer's interest; performance defaults by a Department may ripen into a failure-to-pay default.

The FHWA agreed with TxDOT's comment and has revised the Guide accordingly. The Guide introduces discussion regarding where it may be appropriate to include performance-related defaults.

53. The TxDOT commented that the method for calculating termination compensation in the Guide should be revised to reflect the calculation method utilized in certain precedents which provide protection to the lenders and market value for the Developer's equity investment (if such investment is greater than the outstanding debt).

Though the drafting is somewhat different, there is not much substantive difference between the calculation mechanism reflected in the Guide and that proposed by the commenter, though it should be noted that it is appropriate to compensate equity irrespective of how large or small its value is as compared to the outstanding debt. A change to the Guide is not necessary to address this comment.

54. The TxDOT suggested that the Guide mention, as one option for valuing the equity in the Developer, that certain precedents allow the parties to produce

evidence in the event of a dispute for ultimate determination by a court or other dispute resolution forum.

The FHWA agreed with TxDOT's comment and has revised the Guide accordingly.

55. The TxDOT commented that the Guide should provide a comprehensive list of Developer Defaults in acknowledgement that different defaults have different cure periods and methods for curing.

Section 7.3.1 of the Guide includes a comprehensive list of Developer Defaults, and Section 7.3.2 of the Guide states that cure periods may vary depending on the nature of the Developer Default. A change to the Guide is not necessary to address this comment.

56. The TxDOT suggested that the Guide include closure of any lane or other portion of the Project (unless permitted under the agreement) as a Developer Default.

The Developer Default listed at clause (a) of the definition captures this failure by the Developer; the FHWA agrees with the commenter that continued access is a significant objective of the Concession Agreement (and therefore would constitute a failure to comply with a material obligation if not provided by the Developer). A change to the Guide is not necessary to address this comment.

57. The TxDOT commented that the Guide should acknowledge that a particular toll concession agreement may provide for a range of remedies for Developer Default, but limit the remedy of termination to defaults specifically agreed to be material in nature.

The FHWA agreed with TxDOT's comment and has revised the Guide accordingly.

58. The TxDOT commented that the Guide should be revised to state that even if a Developer Default is cured, the Developer may remain liable for Department losses attributable to the default.

The FHWA agreed with TxDOT's comment and has revised the Guide accordingly.

59. The TxDOT commented that because many toll concession agreements provide for termination due to accumulated delay from Delay Events, and not just due to the narrowly defined Force Majeure Events, the discussion regarding likelihood of termination should be revised.

The FHWA agreed with TxDOT's comment and has revised the Guide accordingly.

60. The TxDOT commented that the approach to termination compensation following a Developer Default included in the Guide should be amended to reflect an alternative approach available in the market. In particular, TxDOT felt that the approach taken in the Guide should ensure that equity is wholly at risk of loss and lenders face a meaningful financial consequence if a project is terminated following a Developer Default.

The termination calculation mechanism reflected in the Guide will not provide equity with compensation in the event of a Developer Default. In addition, although it is common to discount compensation payable to lenders after completion of the project (which is reflected in the Guide), it is often the case that

such a discount is not imposed prior to completion because of the risks otherwise inherent in completing a project. A change to the Guide is not necessary to address this comment.

61. The TxDOT suggested that the Guide include a discussion of provisions in certain precedents which provide for no termination compensation for termination due to Developer Default, including where: (i) the Developer files for bankruptcy and rejects the toll concession agreement; (ii) the Collateral Agent receives a replacement agreement from the Department in accordance with the original agreement; and (iii) the Developer wrongfully exercises a termination right.

As it has been noted in the Guide, in the context of a greenfield project where the Department receives a new asset, some measure of compensation is typical and necessary; otherwise, the Developer may be entitled to assert a claim for unjust enrichment. A change to the Guide is not necessary to address this comment.

62. The PECG commented that the Guide should provide the Department with the ability to take over the project should the Developer become unable to meet its obligations.

The Concession Agreement will typically include a Developer Default for failure to pay amounts when due to the Department. This is addressed in Section 7.3.1 of the Guide.

63. The TxDOT suggested that the Guide state that the principle behind the measure of compensation is rescission and restitution.

This is a technical legal issue that is not relevant to the intended audience for the Guide. A change to the Guide is not necessary to address this comment.

64. The TxDOT commented that the discussion of termination compensation in Section 7.4.2 should mention lender breakage costs.

This comment is captured by the first bullet point in the section, which refers to all amounts owed to the lenders. A change to the Guide is not necessary to address this comment.

65. The TxDOT commented that the Guide should discuss the various legal mechanisms used in certain precedents to establish the time at which a termination for convenience is effective.

This is a technical legal issue that is not relevant for the intended audience of the Guide. A change to the Guide is not necessary to address this comment.

Chapter 8: Handback

The comments received on the Guide's review of the issues surrounding changes in equity interests generally related to the Handback Reserve Account.

66. The TxDOT commented that the Guide should acknowledge that certain precedents authorize the use of funds in the Handback Reserve Account for safety compliance work.

The FHWA agreed with TxDOT's comment and has revised the Guide accordingly.

67. The TxDOT also suggested that the Guide should acknowledge that certain precedents rely on a mechanism other than an independent consultant in determining the amount necessary for the Handback Reserve Account.

The FHWA agreed with TxDOT's comment and has revised the Guide accordingly.

Appendix A: Glossary

The comments received on the Glossary generally related to clarifications on, and scope of, various defined terms.

68. The TxDOT commented that the definition of demand risk should be expanded to include toll collection risk.

The FHWA agreed with TxDOT's comment and has revised the Guide accordingly.

69. The TxDOT commented that the definition of Design-Build Contract should be revised to specifically mention design work.

The FHWA agreed with TxDOT's comment and has revised the Guide accordingly.

70. The TxDOT commented that the definition of Dispute Resolution Mechanism should include disputes review boards.

The FHWA agreed with TxDOT's comment and has revised the Guide accordingly.

71. The TxDOT commented that the definition of Express Toll Lane should be narrowed to limit this concept to traffic lanes subject to tolls which vary in accordance with demand.

The FHWA agreed with TxDOT's comment and has revised the Guide accordingly.

72. The TxDOT commented that the definition of Gross Revenue should be revised to clarify that the insurance proceeds included in Gross Revenue are insurance

proceeds which are received in substitution for, or to compensate for, loss of tolls or user fees.

The FHWA agreed with TxDOT's comment and has revised the Guide accordingly.

73. The TxDOT commented that the definition of Managed Lane Facility should be revised to include language which references change in demand.

The FHWA agreed with TxDOT's comment and has revised the Guide accordingly.

74. The TxDOT commented that the definition of Prohibited Person should reserve the right to prohibit an individual based on a potential investor's egregious reputation, such as suspected affiliation with criminal organizations.

The FHWA agreed with TxDOT's comment and has revised the Guide accordingly.

75. The TxDOT commented that the definition of Subcontractor Breakage Costs should include costs of demobilization.

The FHWA agreed with TxDOT's comment and has revised the Guide accordingly.

76. The TxDOT commented that the definition of Work should include design work.

The FHWA agreed with TxDOT's comment and has revised the Guide accordingly.

77. The TxDOT commented that the definition of Construction Period should be revised to distinguish between the Service Commencement Date and Substantial Completion.

A change to the Guide is not necessary to address this comment. For purposes of simplification, the Guide does not distinguish between Substantial Completion and Service Commencement, as the distinction is not relevant to the Guide.

78. The PECG commented that the definition of Discriminatory Change in Law should be narrowed to provide greater certainty regarding the types of change in law captured under this concept.

A change to the Guide is not necessary to address this comment. The example definition of Discriminatory Change in Law accords with market practice.

Other General or Public Policy Comments

79. A private citizen commented that the Guide should state that P3 transactions include financing of all costs and liabilities incurred on a particular project.

The FHWA appreciates the commenter's concern that P3 projects' transfer of costs does not necessarily mean a transfer of risks; however, a common feature of P3 projects (as reflected in the Guide) is that the parties generally allocate risks (and costs associated with them) to the party best positioned to manage them. It would be incorrect to suggest that P3 projects involve the private sector financing all costs and liabilities associated with the relevant project. A change to the Guide is not necessary to address this comment.

80. The Commonwealth of Virginia commented that FHWA should include an explanation of the advantages and challenges associated with risk allocation under a P3 procurement model in a way that is easily understandable to public decisionmakers.

The FHWA agrees that each project is unique, and that the circumstances of each project will determine the allocation of risk and responsibilities for the life of the project. This aspect of P3 transactions has been highlighted throughout the Guide, though not necessarily in the context of public funding decisions (a topic which has not been addressed in the Guide). However, FHWA agrees that the extent of public funding involved in any project will have an impact on the allocation of risk associated with that project.

81. The Commonwealth of Virginia also commented that FHWA should consider a review of Federal procurement requirements and regulations to supplement the Guide.

A comprehensive review of the Federal procurement requirements is not within the scope of the Guide.

82. The Commonwealth of Virginia commented that the Guide should reflect that under an availability payment structure, the risk of maintaining the level of service of a particular road will be transferred to the private sector.

The FHWA will address availability payment structures and related issues in a separate guide in due course.

83. A private citizen observed that under California law, a State agency is responsible for monitoring compliance with environmental regulations.

The FHWA notes that Concession Agreements cannot alter existing State or local law mandates that require a particular entity to maintain legal liability for a particular aspect of a project. However, Concession Agreements may transfer the risk associated with that aspect of the project by: (a) allocating responsibility to

one party (such as the Developer) for paying and performing the relevant obligations on behalf of the other party (such as the Department); and (b) requiring that the party responsible for paying and performing thereafter indemnify the other party for the resulting consequences. As the issues associated with such requirements are highly dependent on applicable State and local laws, they have not been addressed in the Guide. A change to the Guide is not necessary to address this comment.

84. The PECG suggested that in P3 procurement the contractor should prepare plans and specifications to meet the standards of the Department.

The FHWA notes that the Concession Agreement will typically prescribe technical specifications that must be followed by the Developer, and will provide for review and approval by the Department of various design and construction submissions in the ordinary course. These matters are rarely contentious and will be consistent with Departments' experiences on other non-P3 transactions, so they have not been addressed in the Guide. A change to the Guide is not necessary to address this comment.

85. The PECG commented that the environmental and first 30 percent of design work should be completed by the Department and provided to the contractor.

The FHWA notes that Concession Agreements will typically require the Developer to construct the Project in accordance with environmental approvals that have been obtained by the Department. These matters are rarely contentious and will be consistent with Departments' experiences on other non-P3

transactions, so they have not been addressed in the Guide. A change to the Guide is not necessary to address this comment.

86. The PECG commented that construction inspection should be conducted by the Department.

Concession Agreements include completion tests which require, among other things, that the work is completed in accordance with the requirements of the Concession Agreement (including the technical specifications), and that the work must be verified by the Department. These matters are rarely contentious and will be consistent with Departments' experiences on other non-P3 transactions, so they have not been addressed in the Guide. A change to the Guide is not necessary to address this comment.

87. The PECG commented that the Guide should direct Departments to specify standards of operation and maintenance if a particular P3 procurement is to include operation and maintenance.

Concession Agreements will specify the applicable operations and maintenance standards that must be complied with. The Developer will be required to comply with these at its own cost and expense. These matters are rarely contentious, so they have not been addressed in the Guide. A change to the Guide is not necessary to address this comment.

88. The PECG suggested that the Guide should reserve for the Department the right to access the project at all times, and require the Developer to maintain the project according to the Department's standards.

The Concession Agreement will typically permit the Department to have access to the Project for oversight purposes, and will include a variety of remedies for the Department in the event the Developer fails to meet the required operation and maintenance specifications (including the right of the Department to perform the obligations on behalf of the Developer). These matters are rarely contentious and will be consistent with Departments' experiences on other non-P3 transactions, so they have not been addressed in the Guide. A change to the Guide is not necessary to address this comment.

89. The PECG commented that the Guide should require Developer to maintain the project at full operational capacity at all times, with the Department able to levy fines for failure to comply with this requirement.

The FHWA notes that it is typical for Concession Agreements to include a requirement that the Developer must keep the Project open for traffic 24 hours a day, 365 days a year, following Substantial Completion. In the context of a demand risk transaction, where the Developer's revenue depends on keeping the road open to paying users, this obligation is not contentious and therefore has not been addressed in the Guide. A change to the Guide is not necessary to address this comment.

90. The ARTBA expressed support for including in the Guide a discussion of the risks and costs associated with preparing and submitting a proposal for a design-build project. The ARTBA also commented that the Guide should include a discussion of risk allocation and compensation as between the Developer and the design-build contractor in the same way that the Guide discusses the allocation of

risk between the Department and the Developer, and that the Guide should provide recommendations regarding the relationship between the Developer and the design-build contractor.

The Department's contractual relationship is with the Developer, not with the design-build contractor. The Developer's approach to managing the risks allocated to it, whether through contracting or otherwise, is not appropriate for the Department to regulate. A change to the Guide is not necessary to address this comment.

91. A private citizen expressed concern about the characterization of a Concession Agreement as a lease in the underlying asset and the characterization of resulting revenue, and suggested that FHWA consider alternative methods of financing infrastructure.

The FHWA acknowledges that P3 procurement may be an unfamiliar tool for funding infrastructure investment to some members of the public. The characterization of the Developer's interest in the project (whether as a lease or a license) varies from one jurisdiction to another. Some Concession Agreements include the requirement for revenue sharing, which is similar to lease payments. The Concession Agreement will also require the Developer to pay all costs to operate and maintain the Project during the term of the agreement. The shouldering of these costs is also not unlike a lease payment. A change to the Guide is not necessary to address this comment.

92. Several private citizens provided suggestions for Departments considering P3 procurement, including the following: parties should adopt a statement of policies

to reduce the risk of misinterpretation of a contract; FHWA should suggest that Departments undertake a cost/benefit analysis prior to deciding to engage in P3 procurement; in relation to a cost/benefit analysis for an existing asset, payments projected to a potential private operator should not exceed the cost of public bonds or borrowing should the asset continue to be operated by the Department. While these comments provide interesting and potentially useful ideas, they are not within the scope of the guidance mandated by MAP-21, and therefore, no changes to the Guide have been made as a result of these comments.

93. Several private citizens expressed support for transparency in P3 procurement and offered the following suggestions: P3 procurement should be subject to public auditing and financial statement disclosure requirements, and be approved by State and municipal elected officials; and P3 procurement contracts and related documents should be subject to the Federal Freedom of Information Act (FOIA) and all State and local public records disclosure laws.

Concession Agreements will typically include regular reporting requirements, particularly where there is a sharing requirement that requires ongoing review of costs and revenues. To the extent a Developer is a publicly traded company, public disclosure of financials continues to be required. Each jurisdiction will have its own rules and regulations regarding the procurement of P3 transactions and approvals required to be obtained prior to executing a Concession Agreement. Such rules and regulations are outside the scope of the Guide. Concession Agreements are subject to FOIA-type laws and regulations in many jurisdictions, though Developers typically have the right to specify that certain information is

proprietary or constitutes a trade secret exempting it from disclosure in accordance with such laws. These matters are rarely contentious and will be consistent with Departments' experiences on other non-P3 transactions, so they have not been addressed in the Guide.

94. A private citizen expressed a concern that the use of tax-exempt bonds in relation to P3 procurement contradicted the stated goal of using P3 procurements to encourage the investment of private capital.

This comment reflects a misunderstanding of the way in which tax-exempt bond issuances work. Although a public issuer may nominally issue bonds for tax purposes (known as a conduit issuer), the proceeds raised from the sale of the bonds are immediately lent to the Developer under a separate loan agreement, and the Developer will be responsible for paying all amounts that are ultimately due to the bondholders. There is no public guarantee of debt when this approach is taken, and this structure is customary in the context of non-P3 arrangements as well. No changes have been made as a result of this comment.

95. The ARTBA commented that the Guide should address performance bonding requirements and the potential need for legislation to address performance security requirements for toll concessions.

The topic of performance security will be addressed in the addendum to the Guide.

96. Ernst & Young commented that the Guide should include a discussion of milestone or final acceptance payments.

The FHWA has not included a discussion of construction payments from States within the Guide. The ability and willingness of States to finance such payments, and the constraints associated with the sources of funds that might be used, will vary widely from one jurisdiction, and often one project to another. As a result, it would be difficult to describe general principles that will be of much utility to State DOTs. A change to the Guide is not necessary to address this comment.

97. Ernst & Young commented that FHWA should include a discussion of independent engineers and effective strategies for efficiently managing approvals, oversight, and disputes in the addendum.

While FHWA agrees that independent engineers and oversight mechanisms are important topics, the addendum will not address this topic. However, dispute resolution will be addressed in the addendum.

98. Ernst & Young commented that FHWA should consider partially variable term lengths in its discussion of term lengths in the addendum.

The FHWA notes that this topic may be considered in the addendum.

99. Ernst & Young commented that FHWA should consider including a discussion of plate denial.

The FHWA considered discussing this topic in the Guide, but ultimately did not address this issue as it may be considered controversial in some jurisdictions.

100. Ernst & Young commented that FHWA should address incentives to lender step-in/rectification and the role of direct agreements in the addendum.

The FHWA notes that lenders' rights will be addressed in the addendum.

101. The PECG commented that the Guide should include an indemnity of the Department to be provided by the Developer.

The FHWA notes that Indemnities will be addressed in the addendum.

FINAL GUIDE & OTHER MODEL CONTRACT P-3 PRODUCTS: The FHWA is not accepting any further comments regarding the Core Toll Concessions Public-Private Partnership Guide. The final version can be found on the docket (Docket No. FHWA-2014-0006) or at the following link:

http://www.fhwa.dot.gov/ipd/pdfs/p3/model_p3_core_toll_concessions.pdf

In addition to the Core Toll Concessions Public-Private Partnership Guide above, FHWA is also developing an Addendum document that will cover secondary, yet important provisions found in P-3 contracts. The secondary provisions will include issues such as performance standards, contract length, capacity triggers, consumer protections, Federal requirements, developer indemnities, lenders rights, insurance dispute resolution, and performance security. The provisions will be covered in less detail than the provisions in the Core Guide.

Another type of P-3 contract is the availability payment based contract. Funds from public sector revenues are the sources of payments to the private contractor in these transactions. These availability payments based transactions are increasingly popular. Many of the provisions found in the toll concessions guide will also be germane to the availability payments guide. The FHWA will be publishing an Availability Payments Model P-3 Contracts Guide in 2014.

Authority: Section 1534(d) of MAP-21 (Pub. L. 112-141, 126 Stat. 405).

Dated: August 27, 2014.

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Gregory G. Nadeau
Acting Administrator
Federal Highway Administration

[FR Doc. 2014-21049 Filed 09/09/2014 at 8:45 am; Publication Date: 09/10/2014]