Federal Highway Administration
Docket FHWA 2014-0006
Draft Toll Concession Public-Private Partnership (P3) Model Contract Guide—Addendum

Comments from the American Subcontractors Association (ASA), Surety & Fidelity Association of America (SFAA) and National Association of Surety Bond Producers (NASBP) to address Chapter 9 of the Addendum on Construction Performance Security

A P3 is Just Another Method to Finance and to Deliver a Public Works Project.
In Chapter 9, FWHA characterizes a P3 as a financial and/or credit transaction between a public entity and a private partner under which the public entity obtains a completed public works project in the short run and repays the private partner over the long-term, which typically is 30 years or more. This leads FHWA to its conclusion that the appropriate level of construction performance security on a P3 should be a function of the credit strength of the design-build contractor, the complexity of the project, and the payment arrangements under the design-build contract. In the absence of any bonding requirements, the bidders and their equity and debt providers should determine the most cost effective and creditworthy approach to construction performance security.

A P3, however, is simply another method to finance and to deliver a public works project. Although the public works project in a P3 may not be financed initially with public funds, public funds in the form of some future revenue stream (e.g. tolls; availability payments; tax credits; loans) are committed to the private partner upfront in the P3 agreement and ultimately are the source of funding and the profits/return on investment for the private partner and the investors. In 2014, the U.S. House Transportation Committee formed a panel that studied the use of P3s. Among its findings were that P3 agreements often involve significant federal assistance through credit and tax programs, such as the Transportation Infrastructure Finance and Innovation Act (TIFIA) program and Private Activity Bonds (PABs) for both public and private parties. Because of significant amounts of public funding in P3s for infrastructure projects, the Panel called for greater transparency and accountability to assure that the P3 agreements are in the long-term interest of the public and that an accurate accounting of the costs and benefits of the agreement and the total federal investment are realized.

Congress previously expressed the need for transparency and for accountability in construction privatization efforts when it required bonding on all military housing privatization projects. In 2008, Congress included in the National Defense Authorization Act for Fiscal Year 2009, which is now codified at 10 U.S.C. § 2885, "Oversight and accountability for privatization projects," mandating surety bonding levels for military housing privatization projects. Specifically subsection (c) states:

> *The Secretary concerned shall ensure that the project owner, developer, or general contractor responsible for a military housing privatization initiative project has sufficient payment and performance bonds or suitable instruments in place for each phase of a construction or renovation portion of the project to ensure successful completion of the work in amounts as agreed to in the project's legal documents, but in no case less than 50 percent of the total value of the active phases of the project, prior to the commencement of work for that phase.*

Congress prudently enacted these protections in response to significant performance and quality issues on privatized military housing projects in 2007. In short, Congress selected a tried and true mechanism—surety bond requirements—that it well understood had a long record of value to the federal government and to taxpayers and that would ensure project quality. The end result of a P3 infrastructure project is a work for public use and benefit. The chief interest of a public entity is to ensure the ultimate delivery of the needed road, bridge, or other infrastructure for the benefit of the public and to ensure that downstream parties, the subcontractors and suppliers, supplying labor and materials on such projects, are paid. Such interests remain the same regardless of whether the public works project is financed and delivered through a P3 or through a more traditional method.[1] In fact, the need for the Department to step in and complete the project (as contemplated in Chapter 12) is minimized significantly when performance and payment bonds are in place.

Viewing the P3 in the way that FHWA should—as a method to deliver a public improvement—would result in guidance similar to that provided by other federal agencies in cases where they are not the procuring agency, but still advocate bonding to protect the federal interest.[2] See, e.g. Federal Transportation Administration 4220.1E (Third Party Contracting Requirements) "*FTA may accept the bonding policy and requirements of the grantee, provided FTA determined that the policy and requirements adequately protect the Federal interest. FTA has determined that grantee policies and requirements that . . . [require performance and payment surety bonds] adequately protect the Federal interest."*

Further note that the Department of Transportation issued 49 CFR Part 18, the "Uniform Administrative Requirements for Grants and Cooperative Agreements to State and Local Governments." This addresses bonding for state-level construction projects financed partly by federal grants. It states in part:

> *For construction or facility improvement contracts or subcontracts exceeding the simplified acquisition threshold, the awarding agency may accept the bonding policy and requirements of the grantee or subgrantee provided the awarding agency has made a*

[1] In this regard, the addendum should address the surety's rights to step-in and complete a project, similar to Chapter 11, which addresses a Lender's remedial rights.

[2] As an indication that FHWA is viewing P3s as primarily a financial transaction, the Addendum omits several public policy issues that arise from the failure to complete an improvement under the P3 procurement method, such as increased completion costs and the denial to the public of the benefit to use the improvement.

determination that the awarding agency's interest is adequately protected. If such a determination has not been made, the minimum requirements shall be as follows:

(2) A performance bond on the part of the contractor for 100 percent of the contract price. A "performance bond" is one executed in connection with a contract to secure fulfillment of all the contractor's obligations under such contract.

(3) A payment bond on the part of the contractor for 100 percent of the contract price. A "payment bond" is one executed in connection with a contract to assure payment as required by law of all persons supplying labor and material in the execution of the work provided for in the contract.

Federal and State Bond Requirements Are Grounded in Sound Public Policy.

The FWHA addendum suggest that there are "Little Miller Acts" in only a handful of states and that bonds are required on P3s in the U.S. simply because they are required. Bonds are required by the federal government and all states (under Little Miller Acts) and many other local government units for sound public policy reasons. A fully performed project and paid subcontractors and suppliers is sound public policy. While a P3's financial structure and payment arrangements may provide some protection for the public entity's financial risk, they do not assure that the public construction project in a P3 will be completed on time and according to the terms of the contact. Private owners also choose to bond their projects, even without legal mandate, because they value the surety's prequalification of contractors as an effective risk mitigation strategy.

The performance bond guarantees that the public works project is completed according to the construction contract. If a performance bond is not provided, the public entity and its taxpayers take on the risk should the contractor default and bear the burden of re-letting work and paying any excess completion costs. It has been the surety industry's experience that the completion costs for a defaulted project cannot be estimated with certainly but typically are higher than anticipated. By contrast, when a performance bond is in place, the full amount of the bond is available to complete the project in the event of the contractor's default. Public entities often do not have adequate resources to perform all of the tasks that the surety does, either in prequalification of contractors or in the servicing of claims brought on by contractor default. Experience has shown that performance bonds are a cost-effective way for a public entity to protect itself and the project in the event of default.

The surety's underwriting of a bond is crucial to the success of public works projects. The surety provides a bond only to contractors that, in the surety's estimation, are capable of performing the work. The surety examines the contractor's expertise in the work, character, ability to work in the region where the project is located, current work in progress, and overall management, as well as its capital and record of paying its obligations. By issuing a bond, the surety provides the public contracting entity with assurance from an independent third party, backed by the surety's own funds, that the contractor is capable of performing the construction contract.

Yet, FWHA concludes appropriate level of construction performance security on a P3 should be a function of the credit strength of the design-build contractor, the complexity of the project, and the payment arrangements under the design-build contract and that the bidders and their equity and debt providers should determine the amount of construction performance security. Thus, FHWA suggests that the amount of performance security for a design-build contractor with high financial strength should be lower than a contractor with relatively low financial strength.

The public entity wants to get a public works contract completed on time and according to the construction contract and to assure all subcontractors, suppliers, and workers on the job get paid. Surety bonds assure that the construction of the public works project is entrusted to qualified contractors. Assuring that the design-build contractor is financially capable is a benefit of bonds. It is nonsensical to think that a public entity would want to engage with a design-build contractor with "comparably low financial strength" as suggested in Chapter Nine of the Addendum.

Public entities at all levels of government have realized that the credit strength of the contractor is not sufficient to determine whether to require bonds. Is any private business or entity really too big to fail? One only need look back less than 20 years to see a list of well established and well respected large heavy construction companies that have filed for bankruptcy; names like Morrison Knudsen (1905-1995), Guy F. Atkinson (1926-1997), and J.A. Jones (1890s-2003). A more recent name is Modern Continental (1967-2008), the largest contractor on the Big Dig. In 2000, Modern Continental was a $1.3 billion company with over 4,000 employees. While Modern Continental's problems started with a default on a wastewater treatment plant project, the issues it encountered on the Big Dig (including a guilty plea to 39 federal charges) led it to file for bankruptcy in 2008. The successful completion of the Big Dig should be credited to the surety claim department that managed the claims and financed Modern Continental to completion of its projects and ultimately filed a proof of claim in the bankruptcy for hundreds of millions of dollars.

Even more recently, Ballenger Construction Company (1937-2012), a large Texas road contractor, filed for bankruptcy in December 2012 leaving millions of dollars in bills to subcontractors, suppliers, and others on 20 bonded transportation projects with a total value of $356 million. About $112 million of work remained on the Ballenger contracts when the company went out of business. Ballenger was founded in 1937 and had 550 employees, all of whom were laid off. Ballenger's sureties again are managing the claims and making sure the projects get completed and the subcontractors and suppliers that timely file proper claims are being paid.

Large contractors need the surety's prequalification in a P3 just as in any other public works project. The surety does not look just at the contractor's qualification to complete the public works project upon which the contractor submits a bid. Rather, the surety reviews all of the contractor's works in progress to make a determination that the financing, equipment, workers, and other resources will be available and on location when the new project starts.

To the extent that a P3 has construction elements, the construction risk is the same under a P3 as any other delivery method, and construction is a risky business. It needs to be bonded.

The Approach Taken in P3 Markets Outside of the United States is Not Relevant To Performance Security Requirements in the United States.

In comparing foreign procurement practices to the U.S. system, FHWA makes no comment regarding payment bonds to protect subcontractors, suppliers, and workers on public works projects in a P3. The payment bond required in the U.S. guarantees that covered subcontractors, suppliers, and laborers on the job will get paid and they must rely on the general contractor's payment bond for protection. Generally, mechanics liens cannot be asserted against public property, and we assume that subcontractors, suppliers, and workers on the job will not be able to protect themselves by asserting a lien on the property on which the P3 is engaging in construction. If no payment bond is required, these parties are left with no means to collect for their services and supplies if the contractor is unable or unwilling to pay them. Typically, subcontractors and suppliers extend large amounts of credit prior to submitting an invoice to the general contractor, knowing that payment is forthcoming for completed work. Without a payment bond in place, subcontractors and suppliers face substantially increased risk of nonpayment. A project the size of many P3s presents the subcontractors and suppliers with immense exposure if no payment bond is available. Many subcontractors and suppliers on public works projects are small businesses that have fewer resources to absorb an event of non-payment. Public owners and taxpayers also will pay the price if the most skilled and financially sound subcontractor and suppliers forgo participation on projects without bonds in place for less riskier projects in the U.S.

FHWA should not look to markets outside the U.S. for guidance regarding performance security, because the environment, practices, public policy interests, and history regarding performance and payment security is vastly different in the U.S. Other countries have different approaches to public funds and include no protection for subcontractors and laborers on public projects. They do not look for the security posted on a public construction project to address completion of the project or to pay workers, but rather require only a small demand guarantee. Many countries require only a 5% to10% letter of credit as the security on any public construction project, and their P3 projects follow that approach. In the countries that do require a higher-percentage conditional guarantee, that same percentage normally is required for P3 projects as well. The U.S. also has other protective laws, such as Davis Bacon or OSHA, that do not exist overseas. Should these protections also be removed simply because they do not exist in the current laws in Europe when foreign private partners invest in P3s in the U.S.? If there are customs and practices we should adopt, we should, but we cannot eliminate the best practices and proven protections.

Here in the U.S., we have a procurement system that guarantees that significant funds will be available to pay for completion of the work and payment of workers in the event a contractor defaults on a public works project. Other countries treat P3s like any other public construction project, and P3s in the U.S. likewise should be treated as any other public construction project and require bonding. There is no reason to adopt a foreign approach to P3 projects here at home.

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American Subcontractors Association
ASA is a national trade association representing subcontractors, specialty trade contractors and suppliers in the construction industry. ASA members work in virtually all of the construction trades and on virtually every type of horizontal and vertical construction. ASA members frequently contract directly with construction owners, including various government entities.

More often, they serve as subcontractors dealing with construction owners through a prime contractor. More than 70 percent of ASA members are small businesses.

National Association of Surety Bond Producers
Founded in 1942, the National Association of Surety Bond Producers (NASBP), www.nasbp.org, is the association of and resource for surety bond producers and allied professionals. NASBP members specialize in providing surety bonds for construction contracts and other purposes to companies and individuals needing the assurance offered by surety bonds. NASBP members engage in contract and commercial surety production throughout the United States, Puerto Rico, Guam, and a number of countries. They have broad knowledge of the surety marketplace and the business strategies and underwriting differences among surety companies. As trusted advisors, professional surety bond producers act in many key roles to position their clients to meet the underwriting requirements for surety credit.

The Surety & Fidelity Association of America
The Surety & Fidelity Association of America (SFAA) is a District of Columbia non-profit corporation whose members are engaged in the business of suretyship. Member companies collectively write the majority of surety and fidelity bonds in the United States. SFAA is licensed as a rating or advisory organization in all states and it has been designated by state insurance departments as a statistical agent for the reporting of fidelity and surety experience. SFAA represents its member companies in matters of common interest before various federal, state, and local government agencies. SFAA has departments handling: statistical information, regulatory filings, publications, government affairs, membership, and both surety and fidelity bond underwriting.