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The Potential Use of DRBs on Public Private Partnership Projects

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There is a funding crisis for transportation infrastructure in the United States due to the ever increasing costs of rehabilitating, replacing and upgrading these critical assets. At the same time the weak economy in the U.S. and shortage of public funds are stretching government budgets to the breaking point. Simply put, there is not enough public money to fund major infrastructure projects that are vital to the continued economic competitiveness of the nation.

This funding crisis is fostering a new importance for public private partnerships (“P3”) in the menu of project delivery options for public infrastructure projects. P3s can attract private sector funding sources and improve project delivery and timing by utilizing innovative financing and integrated contracting methods. P3s can range from completion of a facility under a design-build contract to privatization of a facility with long term operating obligations.

Dispute avoidance and dispute resolution in any new and complicated form of project delivery takes on greater importance due to the new and different contractual relationships that are formed, especially the intersection of public and private interests in what has traditionally been a government function. This article addresses some considerations for the potential use of Dispute Review Boards (“DRBs”) in the context of P3s. Transportation P3 projects, such as a toll road project or a rail transit project, are the focus since they are often more expensive and carry higher risks for all parties. For purposes of this article, the authors will assume a full P3 model that includes design, build, operate and maintain responsibilities over a 30 to 50 year period.

Background on P3s

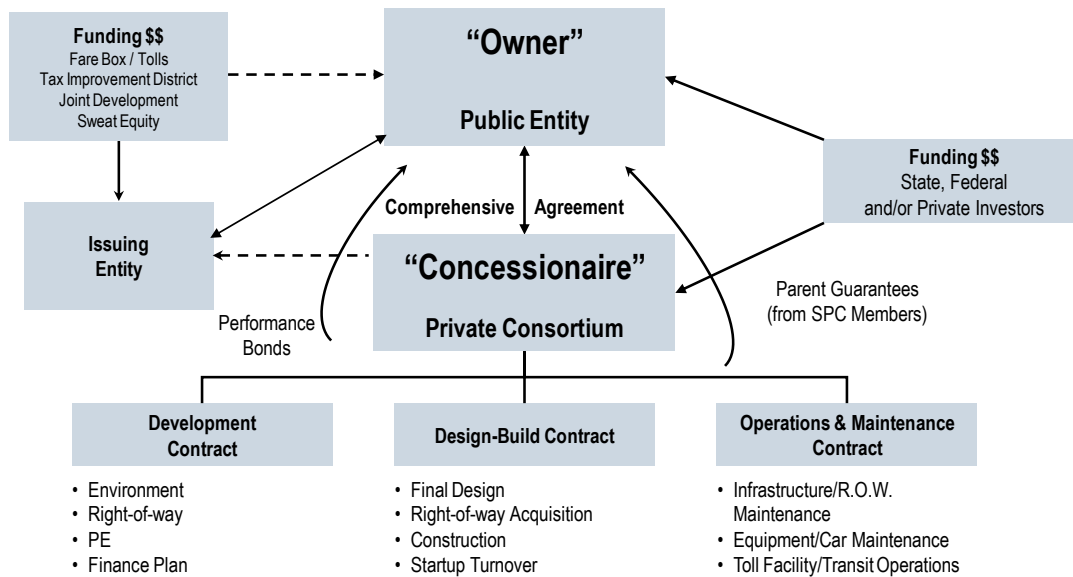
To work best, P3s are structured to share risk and reward between the public partner and the private partners. A project structure must be established that integrates all the necessary elements of the project into one endeavor: planning, environmental permitting and compliance, financing, procurement, design, construction, user fee setting, operations, maintenance and capital asset replacement, and “hand back” requirements. A typical P3 will include a master agreement, referred to here as the comprehensive or concession agreement (“CA”), between the public partner (“owner”) and the private partner (“concessionaire”). Within the CA there may be one or more requirements for the Concessionaire to perform: project development; project financing; design-build delivery; operations and maintenance (“O&M”); and capital asset replacement.

FIGURE A indicates how a typical P3 is structured. The owner is best served working through a single, accountable “at risk” entity (the concessionaire) representing the interests of the entire project and delivering it with the optimum balance of planning, design development, construction costs, delivery schedule,

operations, and life cycle costs. Underneath the concessionaire there are often major contracts and subcontracts with a design-build contractor, prime subcontractors, an operator and, possibly, a major equipment supplier. In addition there will be financial lenders that are backing the concessionaire - the financial lenders will have a direct interest in the costs and timing of delivery and operation of the facility since it provides the revenue stream financing the project construction and operational costs the lenders are underwriting.

FIGURE A

PPP Project Structure



Claim Risk Profile of a P3

In order to assess the utility of using DRBs, the development of a claim risk profile is helpful. The following are some potential types of claims that may arise under a P3 contractual arrangement:

The Owner—Concessionaire Interface: Although in the typical P3 most of the project delivery risk (and associated control) is allocated to the concessionaire and its team, there are still contractual issues that remain between the owner and concessionaire, especially with respect to (a) environmental permitting and compliance issues, (b) utility relocation and right of way acquisition, (c) force majeure events and (d) issues that require owner input or approval on design decisions and performance requirements. Sometimes financial issues also come into play, for example where fundamental assumptions on traffic, user rates and costs prove to be incorrect.¹ In this area of fundamental “deal points,” it is important to have dispute avoidance and resolution systems in place to maintain the commercial relationship between the owner and the concessionaire, particularly when dealing with 30 to 50 year CAs.

Within the Concessionaire Team: The team comprised of the concessionaire, the design-build contractor, prime subcontractors, and operator, together with their financial lenders, retains most of the risk: delivering and operating an infrastructure megaproject with all the challenges inherent in those types of projects. Here, typically the design-build contractor will own “traditional” claims exposure for delay, disruption, extra work, differing site conditions, etc. Avoidance and resolution of these types of claims becomes even more

¹ For example, the operator of the South Bay Expressway filed for bankruptcy in 2010 due, in part, to lower than anticipated traffic volume caused by the recession which adversely impacted its ability to pay debt service on the project.

important where the concessionaire has guaranteed the owner a price and schedule for delivery of the project. There are typically liquidated damages for late delivery where untimely opening of the project to revenue operations may result in financial penalties owed to both the owner and the financial lenders. Ultimately, the concessionaire and its financial lenders are looking to the design-build team to resolve issues so that the concessionaire and its financial lenders will meet their economic goals, as well as deliver the quality product that the owner (and the public) will expect and require.

Current Practice in P3 CAs: Review of a few of the recent transportation CAs that have reached financial closing indicates a current trend for dispute resolution on these projects. Current practice appears to favor the use of an on-call arbitration panel, activated only if and when a dispute arises. Although these are sometimes denominated as “Dispute Boards,” they are not the standing panel associated with DRBs. Sometimes there are two types of panels identified in CAs, one for “technical issues” and one for “financial issues.” Typically the smaller amount dispute decisions are binding and the decisions on larger amount disputes may be subject to appeal in court. The distinction between technical and financial panels has some merit since finance is typically a critical aspect to these agreements.

Is There a Place for DRBs on P3s?

The first question that an owner will ask is whether the owner has less risk of “traditional” claims for additional time or money on P3 projects. Initially, one might conclude that P3s, from an owner’s perspective, are less risky than the traditional design—bid—build projects (DBB Projects) on which DRBs have been used with great success. The reason for this initial conclusion is that under P3 CAs, much of the traditional design risk (under the *Spearin* Doctrine²), coordination risk, and operational risk of the owner is now passed to the concessionaire. The concessionaire, in turn, passes that risk downstream to a design-build contractor, and thence to prime subcontractors, and later to an operator. In addition, many CAs severely limit the grounds on which the concessionaire can make claims against the owner to fundamental commercial “deal points,” as contrasted with typical DBB project changes and claims provisions (for example, constructability issues, differing site conditions, or delay events).

So, if there is a lower risk of claims against the owner for additional time or money from the concessionaire, does that obviate the need for dispute avoidance and resolution mechanisms like DRBs? The authors propose that although there may be differences in the type of claim risks to the owner on P3s, as contrasted with DBB projects, there are still fundamental commercial “deal point” claim risks that warrant consideration of the use of DRBs. In addition, the importance of maintaining a relationship of trust and confidence for 30 to 50 years or more makes the use of a DRB’s standing panel of neutrals even more important. However, as discussed below, the function and scope of the DRB process may need to be changed to some degree to fit the different contractual relationships within the P3 structure.

Another reason for owners to consider using DRBs is that many times owners are subject to public scrutiny as to whether the public’s interests are being protected when what would otherwise be a public project is, in essence, being privatized. The DRB, as an independent, expert, neutral panel can provide transparency and justification to the public for decisions that the owner makes on any claims brought by the concessionaire. Likewise, the concessionaire can use DRB reports as the basis for its decisions and concomitant justification to its financial lenders, as well as its design-build team and operator.

A final reason for the owner to consider using DRBs is that claims between the owner and concessionaire, focused as they often are on fundamental deal points, can presage default terminations³. Defaults on these

² Generally, under the *Spearin* doctrine an owner impliedly warrants that the accuracy and constructability of plans and specifications that it furnishes to a contractor.

³ CAs often include both an owner- and a concessionaire-default provision, so the claims can run in both directions.

types of projects have huge implications for the parties, the financial backers, and the public. The benefit of having expert, neutral opinions on these types of claims can assist both parties from engaging in what is the equivalent of “mutual assured destruction” arising from a contested default termination.

What Kinds Of DRBs Could Be Used?

It is helpful to further explore four potential friction points where claims can arise, in order to assess what type of DRB would fit best with the character of each type of potential claim risk profile.

Friction Point One: Owner—Concessionaire Interface.

The first friction point is the owner - concessionaire interface. Here, as noted above, there will be fewer, but more fundamental, “deal point” claims that can be made. That said, “a claim is a claim,” regardless of its character. Having a DRB available to assist the parties in resolving “deal point” claims can be very helpful to preserving the working relationship, especially where the relationship between the owner and the concessionaire can span decades.

Given the different claim profile of the owner - concessionaire interface, however, there are some aspects of the character and role of the DRB that warrant consideration. First, since the typical project claims for time and money will arise much less frequently as between the owner and concessionaire, the DRB could be an “on-call” DRB similar to the Dispute Resolution Advisor model used by Caltrans⁴. Second, since the owner - concessionaire claims will not necessarily be grounded in the day to day work on the project, the DRB could be comprised of members with different skill sets than a typical engineering and construction management-centric DRB. Law and financial expertise are important skills to be considered, which are somewhat different than those required by traditional DRBs. Third, given the potentially decades-long P3 relationship, the owner and concessionaire might also consider having a DRB for the construction phase and then a different DRB for the operations phase as different types of claims might arise during these project phases.

Friction Point Two: Concessionaire—Design Build

The second friction point is the concessionaire—design-build contractor interface. This interface focuses on the contractual allocation of risk between the concessionaire and design-builder contractor. Under the typical design-build contract the concessionaire will try to mirror its design-build obligations and risks under the CA with the owner, that is, a shedding of design, constructability and delivery issues to its design-build contractor. The types of claims between the design-build contractor and the concessionaire less frequently will involve “deal points” akin to those between the concessionaire and owner. However, they will include more detailed claims issues regarding any limitation of liability that the design-builder may have been able to negotiate, as well as any integration and coordination risk that may exist for equipment operation, start-up and turn over. The same DRB considerations as those relating to concessionaire - owner claims would apply to this interface, i.e., the “on-call” approach with DRB members attuned to the type of claims permitted as between the concessionaire and design-builder contractor.

Friction Point Three: Design-Build Contractor Team

The third friction point lies within the design-build contractor team. The contractual relationship within the design-build contractor team (general contractor, designer/engineer, trade contractors, and suppliers) covers the actual construction and delivery of the project. This contractual interface will encompass the more typical claims that arise from project construction and delivery: design issues, extra work, constructability, delay, interference/disruption, etc. Here, the DRB model that has worked well on many heavy civil projects to prevent and resolve disputes can be used since issues within the design-build contractor team will need to be resolved in “real time” as that is where the work is being progressed and the money is being spent.

⁴ In the Caltrans model, a Dispute Resolution Advisor is appointed at the beginning of a project, is given basic project information, and then is on-call to review and give non-binding findings and recommendation on disputes.

Given the more typical claim profile within the design-build contractor team, the more typical DRB could be used, i.e., formed at the beginning of the project, comprised of engineers/construction managers/construction lawyers, regular site visits, and the DRB claim hearing process.

Friction Point Four: Concessionaire—Operator

The fourth friction point is between the concessionaire and operator. The issues here will revolve around long term operations and maintenance and capital asset replacement requirements. This interface will raise some of the same considerations and the concessionaire—design-build contractor interface. Although the character of the potential claims may be different (operations vs. construction), the avoidance and resolution of claims would still be in the parties’ best interests. There also may be integration and coordination issues caused by the design-build contractor. Therefore, a DRB can still be helpful in avoiding and resolving claims, albeit the composition of the DRB would need to be calibrated to the character of the claims (operational vs. construction) and the degree of involvement could be less because of the lower frequency of claims that would arise out of routine O&M operations and asset replacement requirements.

Potential Options for P3 DRBs

Separate DRBs for Each Interface Friction Point

If one concludes that each of the friction points discussed above could benefit from the dispute avoidance and dispute resolution functions of a DRB, it would be possible to set up a DRB for one or more of the friction points. As noted above, the composition, duration, and role of the DRB would need to be tailored to the claim risk profile based the predictable type, size, and frequency of potential claims. Another option is to implement DRB(s) only for friction points where the parties agree that the additional carrying costs of the DRB(s) are justified.

Omnibus P3 DRB

Although one or more separate DRBs for each friction point is certainly feasible, it does raise some additional challenges to implementation: justifying additional cost (up to four DRBs), additional coordination that will be needed to tailor each DRB for that applicable contractual relationships, and the potential for different results from different DRBs on the same project. One way to address these challenges is to use an “omnibus” DRB that is set up to handle all issues arising on the P3 project, with the costs being shared on a pro rata basis depending on the user of the process. Thus, for example, if the owner and concessionaire did not feel the need for periodic site visits given the limited types of claims that could be brought under the CA or the concessionaire - design-build contractor agreements, the design-builder contractor (that presumably would like periodic site visits for the typical claims within the design-build contractor team) could pay for the periodic visits. Likewise, if there was a claim that was only between the concessionaire and the owner, the concessionaire and owner would pay for the hearing on that claim. Although more complex to administer than the typical DRB, this flexible approach would still be much less costly than the possibility of multiple claim paths and numerous potential arbitrations or litigations.

In addition to saving on transactional costs, the advantage of the omnibus P3 DRB is that it would have a holistic view of the entire project, allowing it to take all appropriate P3 factors into account and thus increasing the likelihood of uniformity and consistency in the DRB’s findings and recommendations across all contractual friction points. Given the broader scope of potential issues, the composition of this type of DRB could include members from a variety of backgrounds, for example finance, construction and legal. The parties could also permit the DRB to retain, with party approval, subject matter experts to assist the DRB if it had to deal with technical issues arising from one of the subsidiary contractual interfaces.

P3 DRB Pool

One question that deserves additional thought is how a P3 DRB would be selected. Since there are at least four primary parties, there may be a benefit in having a pre-selected pool with designated, qualified DRB chairs and members. Panels could involve more than three members if, for example, there was an issue between the design-builder contractor and the operator, which could also involve the concessionaire (holding both of the contracts). Careful consideration would need to be given to: the mix of the pre-qualified DRB pool; how DRBs would be selected (and replaced); and how the DRB pool could be kept apprised of (and to the extent necessary, involved in) the P3 project in order to provide dispute prevention services as well as dispute resolution services.

Conclusion

P3s involve high stakes and high risks for all parties to the deal as a whole regardless of the allocation of risk between particular participants. Although the types of claims may vary among the parties, there is still the same overall risk (indeed, predictability) that claims will arise. The track record of DRBs helping parties resolve claims on major infrastructure projects can be applied with equal force to P3 projects, albeit with thoughtful variation depending on the contractual relationship and potential claims that need to be addressed.

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