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Introduction to the California Infrastructure Finance Act

As communities face infrastructure challenges across the United States, many are looking to public-private partnerships (P3s) as a valuable tool to gain access to private capital and deliver projects in an efficient and timely manner.

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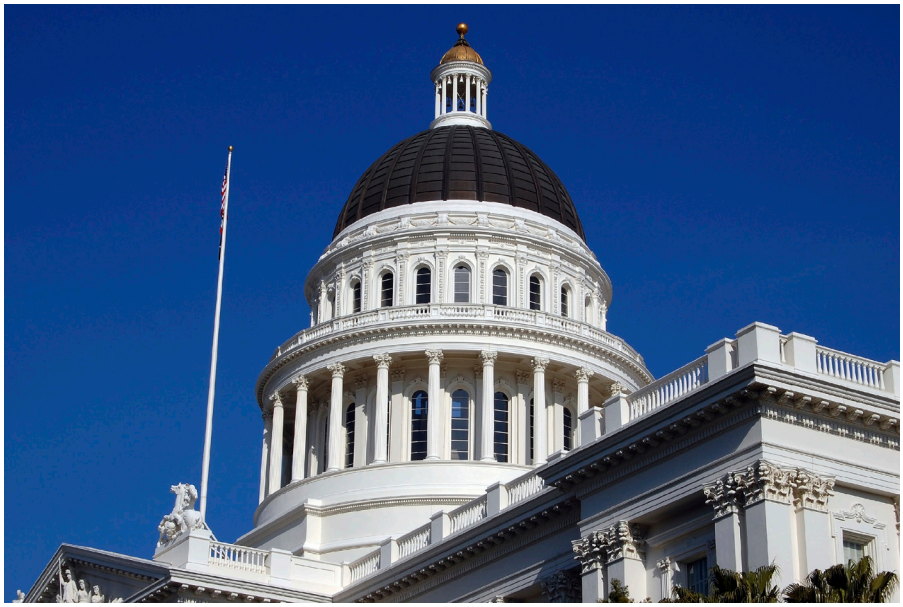

One requirement for successful implementation of a P3 is well-crafted legal authority. Because local and state government procurement laws are normally dictated by state legislatures, most P3 authorities are established on a state-by-state basis, although some cities and counties have also authorized P3 projects pursuant to home rule.

California possesses broad, flexible P3 legislation in the Infrastructure Finance Act (IFA), which was adopted by Assembly Bill 2660 (Aguiar) in 1996 and may be found at California Gvernment Code §§ 5956 et seq. The IFA authorizes local governmental agencies to enter into contracts with private entities for the implementation of certain infrastructure projects. The broad scope of the statute may be seen in the statement of legislative intent in § 5956.1:

> It is the intent of the Legislature that local governmental agencies have the authority and flexibility to utilize private investment capital to study, plan, design, construct, develop, finance, maintain, rebuild, improve, repair, or operate, or any combination thereof, fee-producing infrastructure facilities.

Applicability

The authority created by the IFA extends to all "local governmental agencies," which include charter and general law cities, charter and general law counties, public districts, school districts, joint powers authorities, transportation commissions or authorities, and "any other public or municipal corporation." The act does not grant P3 authority to state agencies or for state projects, which include toll roads on state highways, state water projects and state park and recreation projects. State agencies and projects were excluded to convince Professional Engineers in California Government (PECG, a state employees union) to withdraw its opposition to AB 2660.

Eligible projects must be categorized as "fee-producing" infrastructure, which means that operation of the project must be paid for by the persons benefitted by or utilizing the project. Fee-producing infrastructure commonly include utilities, such as water supply and treatment, wastewater collection, treatment and reuse, refuse disposal and energy production, but also includes transportation projects such as harbors, airports, runways, commuter and light rail, highways, bridges and tunnels if the projects are paid for by users. Buildings and structures are also allowed,

but the statute contains an express exclusion of structures that will be used primarily for sporting or entertainment events.

Selection of the Private Entity

The IFA establishes an independent legal authority for local governmental agencies and does not require an agency to follow other rules related to public contracting. Specifically, the IFA does not overlap with the traditional design-bid-build procurement process set forth in the California Public Contract Code, and other than prevailing wage requirements, the provisions of that code do not apply to projects completed under the IFA. Instead of the traditional public bidding process, the statute requires "competitive negotiation." The Legislature did not prescribe that process, but granted substantial discretion to the governing body of the local governmental agency to determine an appropriate process for each project. The Legislature did impose three important requirements on the competitive negotiation process:

1. The primary selection criteria must be demonstrated competence and qualifications of the private entity for the relevant tasks;
2. The selection criteria shall ensure that the facility be operated at fair and reasonable prices to users; and
3. The competitive negotiation process must prohibit illegal practices such as kickbacks and participation in the selection process by government employees who have a relationship with a private entity.

Other than those three requirements, the IFA does not mandate that a local governmental agency use any particular process. Instead, the statute expressly states that the "competitive negotiation process shall not require competitive bidding," in recognition of the value of flexibility for procurement of P3 projects. In practice, there are likely to be two main ways that a local governmental agency structures the competitive negotiation process.

One, the agency may use a two-step solicitation process, with the first step seeking statements of qualifications from interested firms and selecting a short list of three or four potential bidders, and the second step requesting detailed proposals. Using a qualifications phase is useful to make the process more efficient for both the local governmental agency and interested private entities, and ensures that the best qualified firms submit proposals. A final proposal should be selected based on best overall value for users of the infrastructure facility, rather than lowest bid. A well-executed RFQ/RFP process will include sufficient structure to obtain highly competitive proposals from well qualified firms, but will leave sufficient flexibility for those firms to use their experience to propose innovative technological and design approaches.

Two, the local governmental agency may receive unsolicited proposals from private entities pursuant to § 5956.5. Unsolicited proposals may come in competition with a design-bid-build procurement process, in which case the local governmental agency may use that process as the comparator to satisfy the requirement of competitive negotiation. In such a scenario, the agency would negotiate the best commercial terms available with the private entity, and then compare the outcome to the lowest bid received under the design-bid-build process. An unsolicited proposal might also come outside of any prior agency consideration of the infrastructure project, which challenges the agency to devise a process that ensures some level of competition while recognizing the value provided by the private entity making the original unsolicited proposal. This is likely the hardest challenge an agency might face in implementing a P3 project under the IFA.

Terms of the P3 Agreement

Following the competitive negotiation process, the local governmental agency and private entity will execute a comprehensive agreement covering all aspects of the P3 project development. P3 contracts tend to be long and complex, often made up of several integrated agreements. In particular, such contracts must be carefully coordinated with the environmental review process under the California Environmental Quality Act (CEQA), although execution of a P3 agreement itself does not trigger environmental review.

The IFA requires a number of provisions to be included in a comprehensive agreement, including specific identification of the actions to be performed by the private entity. Although proposals are often received from consortia of private entities, there should be a single private entity for contracting. The infrastructure facilities must be owned by the local governmental agency at all times, unless the agency determines in its discretion that there is a good public reason why the private entity should own the facilities. The agency may lease the facilities to the private entity for up to 35 years, but if tax-exempt debt is used to finance the project, a shorter term may be required by IRS rules governing private business

use of bond proceeds. At the end of the lease period, all facilities must revert to ownership and possession of the agency at no charge. The P3 contract must provide that the agency may buy out the private entity during the lease period, subject to payment of a break-up fee.

Sources of Financing

One of the primary reasons why a local governmental agency might be interested in pursuing a P3 project is to gain access to new financing sources. Under the IFA, a project may be financed using private capital, reserves or debt from the local governmental agency or federal funds. A project may not be financed using state grant funds.

Ultimately, P3 projects are paid for by users of the infrastructure, normally through some type of user fee. Fees must be set by the local governmental agency, with no delegation of that responsibility to the private entity. Revenues from user fees must be dedicated exclusively to pay for direct and indirect capital and operations costs of the project and cannot be diverted by the local governmental agency for other purposes. The IFA includes extensive provisions regarding public hearings about fees, and the private entity must prepare an annual audit report for the public to increase transparency.

As may be clear from the discussion above, P3 projects are very complex, and the process is unfamiliar to many governmental agencies. There is great value in consulting with experienced project, finance and legal experts for the procurement process and contract structure. The final comprehensive agreement between the parties may provide for reimbursement of such costs incurred by the local governmental agency, but the agency should be prepared to expend the resources necessary to protect and promote the public interest.

Conclusion

The IFA provides a broad, flexible authority for local governmental agencies in California to implement P3 infrastructure projects. While the statute requires a competitive process and contract terms that protect the public interest, the Legislature has given local agencies substantial discretion on how to create a procurement process and contract that fit the needs of the particular infrastructure project. As public finances are increasingly challenged at the same time that infrastructure needs are increasing, more agencies are likely to turn to P3s as one tool for project implementation. P3s allow efficient and cost-effective infrastructure delivery around the world, and California is poised to take advantage of P3 projects to increase the quality of life for its citizens, and improve the environment and economy of the state.

Wes Strickland specializes in helping clients develop, acquire and monetize water resources and infrastructure. He commonly represents public and private corporations, government enterprises, investment funds and private water right holders.

Wes is a regular writer and speaker on water resource and investment issues. He serves as the legal columnist for American Water Intelligence and is the author of the PrivateWaterLaw Blog and @PrivateWaterLaw.

Earlier in his career, Wes served as a captain and judge advocate in the United States Marine Corps, where he handled water right matters for the western United States and the U.S. Department of Defense utilities privatization initiative.

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