

MEMORANDUM

TO: Diversion Authority Administrative Advisory Committee

FROM: John T. Shockley

DATE: May 29, 2014

RE: Proposal for a Public Private Partnership (PPP) Approach to F-M Diversion Project



I. Introduction

A Public Private Partnership (hereinafter, "PPP") would allow the Diversion Authority to contract with a private development company all or part of the design, construction, operation, and financing of the F-M Diversion Project. The United States Army Corp of Engineers (USACE) is very interested in utilizing this type of project financing for the F-M Diversion Project. It should be noted that the United States Department of Transportation has adopted pilot programs to use PPPs for the construction of projects and has developed some federal regulations in this regard.

There are several advantages to a PPP approach. For one, contracting the F-M Diversion Project out to a private company could speed up the timeline of construction and provide increased efficiency overall. In addition, this approach would free the public entities from having to provide oversight for an enormous amount of details and particulars involved with the design, construction, financing, etc., of the F-M Diversion Project. Most of all, the PPP structure would allow the Diversion Authority to leverage a slow money stream from the federal government with local revenues.

Both North Dakota and Minnesota have statutory laws allowing for PPPs. Federal law would also be invoked by the use of a PPP for completion of the F-M Diversion Project. Below is an overview of the relevant North Dakota, Minnesota, and federal laws, as well as an outline of the proposed PPP transaction for the F-M Diversion Project.

II. NORTH DAKOTA LAW

a. Basic Procedure Set Forth by North Dakota's PPP Laws

"A public authority is given broad authority under N.D.C.C. ch. 48-02.1 to enter into agreements with private entities to facilitate constructing public facilities. This interpretation is supported by legislative history including the sponsoring senator's statement that the chapter's purpose is to enable a public entity to draw upon the private sector as the equity source of funding infrastructure development." N.D. AG. Op. 2008-L-08 (2008).

North Dakota law allows a public authority to contract with a private company to design, construct, and operate a "fee-based facility" within its jurisdiction. N.D.C.C. § 48-02.1-03. In this matter, there are several entities with varying jurisdiction over the project. However, the

Cass County Joint Water Resource District (hereinafter the “CCJWRD”), has authority to acquire the necessary right of way for the project and to issue special assessment bonds relating to costs associated with the project. Thus, the CCJWRD would be the public authority with jurisdiction over the F-M Diversion Project for purposes of Chapter 48-02.1 of the North Dakota Century Code. The CCJWRD would be tasked with the administration of implementing a PPP, and the Diversion Authority would maintain policy decision authority over the project. This model is currently being used with respect to the Oxbow, Hickson, Bakkee levee project.

A “fee-based facility” is “a facility that provides a service in which the charge is based on the level of service by users *or a rental fee paid by a public authority.*” N.D.C.C. § 48-02.1-01(4) (emphasis added). In this matter, the rental fee will be paid by a combination of proceeds from the sale of special assessment bonds and proceeds of sales and use tax generated by the City of Fargo and Cass County.

The definition of “fee-based facility” encompasses “public improvements.” *Id.* The term “public improvement,” used throughout the Century Code, includes flood protection. *See, generally*, N.D.C.C. § 40-22-01(4). Thus, the F-M Diversion Project – a “public improvement” project related to flood protection – would fall under the umbrella of the kind of “fee-based facility” that a private company could design, construct, and operate in exchange for a “rental fee” paid by the public authority pursuant to North Dakota’s PPP Laws.

The Diversion Authority is composed of several different “public authorities.” However, CCJWRD has jurisdiction over the project area. The PPP Laws expressly provide:

When a fee based facility is or will be situated in the jurisdiction of more than one public authority, or is or will be an interstate or international facility, the applicable authorities concerned may enter into a compact to delegate to one or more of the authorities or a board appointed by the various authorities the authority to exercise all of the powers, duties, and functions of the other authorities regarding the fee-based facility, including the authority to negotiate and administer the development agreement and any related lease and fee-based concession agreement. In addition, if all public authorities having jurisdiction over a fee-based facility concur, title to or authority over the facility may be tendered to the agreed-upon authority of choice, which may at its option accept the title of authority to administer pursuant to the development agreement and this section.

N.D.C.C. 48-02.1-11 (emphasis added). Practically, this joining and transferring of authority would be accomplished through the execution of a “Joint Powers Agreement” by the members of the Diversion Authority (*see* Section V below). The Joint Powers Agreement would provide that the CCJWRD would obtain the Right of Way. North Dakota law allows the public authority to acquire property or right of way by eminent domain and lease the property or right of way to the private operator. N.D.C.C. § 48-02.1-05. This factor would enable the Diversion Authority, through the CCJWRD, to assemble the necessary property and right of way, and then lease it to the private operator.

The term of the lease can extend for a period of up to fifty years. N.D.C.C. § 48-02.1-06. There must be a term within the lease providing that the lease must be reviewed every five years and may be revised. This is best understood as a public oversight provision. The lease term of fifty years would allow the Diversion Authority to leverage a longer lease-purchase agreement

provision. This would serve as additional incentive/security for a private developer to assume the risk of federal non-appropriations.

The procedure outlined by the PPP Laws for initiating a PPP is fairly straightforward. First, the CCJWRD solicits proposals from private operators for the construction, maintenance, and operation of the “fee-based facility,” in this case, the F-M Diversion Project. *See* N.D.C.C. 48-02.1.03. Before accepting a proposal, the CCJWRD must hold a public hearing and determine that accepting the proposal would be in the public interest. *Id.* If it so determines, the CCJWRD then enters into a development agreement with the private operator whose bid was selected. *Id.*

The PPP Laws provide broad authority to both the private developer and the public authority for completion of the proposed project. Notably, the private developer may “[a]ssemble funds from any available source, including federal, state, and local grants, bond revenues, contributions, and pledges.” N.D.C.C. § 48-02.1-04. To facilitate the project, the public authority “may exercise any power possessed by it with respect to the development and construction of infrastructure projects” and “may provide services for which it is reimbursed with respect to preliminary planning, planning, environmental certification, and preliminary design of infrastructure projects.” N.D.C.C. § 48-02.1-08. If necessary, the public authority may acquire property by eminent domain and lease said property or right of way to the private developer. N.D.C.C. § 48-02.1-05. Thus, the CCJWRD can bring all of its powers to the “table” to assist the private developer in designing, constructing, and operating the project.

b. North Dakota’s PPP Laws in Practice

The enabling statutes for this proposed approach were enacted in 1993 and are codified at Chapter 48-02.1 (“Infrastructure Development by Private Operators”) of the North Dakota Century Code. There has been no case law interpreting this Chapter since its enactment in 1993. However, the Office of the Attorney General has issued two formal opinions regarding the Chapter. *See* N.D. AG. Op. 2010-L-09 (2010); N.D. AG. Op. 2008-L-08 (2008). Both opinions involved the construction of a public aquatic and wellness center in Bismarck through a PPP between the City of Bismarck (Park District) and a private developer pursuant to Chapter 48-02.1.

In 2008, after determining that Bismarck was in need of an indoor aquatics center, Bismarck’s Park District solicited proposals from anyone “willing to offer alternatives for financing, funding and construction of an indoor aquatics/wellness center.” N.D. AG. Op. 2008-L-08 (2008). The only proposal received was from “Streamline,” a nonprofit corporation formed by individuals to promote indoor swimming. *Id.* Following a public hearing, the Park District accepted Streamline’s proposal and approved the project, which had the following basic structure:

1. Bismarck State College, through a Joint Powers Agreement with the Park District, furnished the land upon which the aquatics center was to be built;
2. The land was leased to Streamline under a Development Agreement for the duration of the construction period;
3. Streamline financed and constructed the aquatics center upon the leased land (at a cost of approximately \$8 – \$9 million);

4. The Park District paid Streamline annual rent payments sufficient to cover the costs of financing obtained by Streamline for construction (as well as some other administrative costs);
5. To make its annual rental payments to Streamline, the Park District obtained funds in part from issued bond debt and in part from the gross revenues acquired through operation of the aquatics center;
6. After the aquatics center was built, Streamline leased the facility to the Park District for operation and maintenance (an Operating Agreement provided that Streamline also had the option to transfer ownership of the facility over to the Park District or Bismarck State College at the end of the term).

See id.; *see also* N.D. AG. Op. 2010-L-09 (2010). The structure of this transaction was in line with North Dakota's PPP Laws, with the "fee-based facility" being the aquatics center, the "private operator" being Streamline, and the "public authority" being Bismarck's Park District. A similarly structured transaction is possible for the F-M Diversion Project (*see* Section V below).

III. MINNESOTA LAW

Minnesota Statutes do not have a separate chapter dedicated to PPPs like the North Dakota Century Code does. However, Minnesota Statutes do provide (under the Department of Transportation chapter) that the Commissioner of Transportation "may establish a joint program office to oversee and coordinate activities to develop, evaluate, and implement public-private partnerships involving *public infrastructure investments*." Minn. Stat. § 174.45(emphasis added).

The term "public infrastructure investments" is not defined in this section, but other sections of the Minnesota Statutes have defined "public infrastructure" as "publicly owned physical infrastructure in [Minnesota], including, but not limited to, wastewater collection and treatment systems, drinking water systems, storm sewers, utility extensions, telecommunications infrastructure, streets, roads, bridges, and parking ramps." Minn. Stat § 116J.433; *see also* Minn. Stat. § 116J.431. Thus, infrastructure changes to water flows/systems designed to prevent flooding would likely fall under the umbrella of "public infrastructure investments." Accordingly, it appears that Minnesota law would also allow the establishment of a PPP for the completion of the F-M Diversion Project.

There is additional authority for PPPs for toll facilities related to roads in Minnesota. This authority is contained in Minn. Stat. § 160.84 through Minn. Stat. § 160.98. We will need to look into this authority more.

However, the procedure for establishing a PPP in Minnesota appears to be much more complicated than the statutory procedure set forth by North Dakota law. Pursuant to the above-cited statute, Minnesota's Department of Transportation has established a new Joint Office Program (JPO) for Economic Development and Alternative Finance, which oversees the

development of PPPs in Minnesota.¹ An overview of the JPO's procedures and guidelines is provided on the Minnesota Department of Transportation's website.² The procurement process alone involves at least a dozen steps, multiple decision points, and a handful of agencies/authorities.

The best way to handle the complications presented by Minnesota law is to insert language into the Joint Powers Agreement to the effect that all members of the Diversion Authority agree to utilize North Dakota law to contract with a private operator to build, construct, maintain and finance the F-M Diversion Project.

IV. FEDERAL LAW

~~NEED TO DEVELOP THIS SECTION~~

V. OUTLINE OF PROPOSED PPP TRANSACTION FOR F-M DIVERSION PROJECT

Below is an outline of the steps involved in the proposed PPP transaction for the F-M Diversion Project; the steps are organized in (approximate) chronological order. Please note that this outline is still in the initial drafting stage and may need to be altered after further development of this idea. Attached is a flow-chart for ease of discussion.

For brevity, this outline will use the fictitious name "Build Co." to refer to the private operator whose bid is eventually accepted. This outline will presume that the CCJWRD has undergone the proper bidding process, held a public hearing, and decided that it is in the public's best interest to select Build Co. as the private operator for this PPP transaction. Of course, given the scope, purpose and projected timeline of the F-M Diversion Project, Build Co. would need to be able to show that it has the financial ability, capability, capacity, etc. to stick with the Project for several decades until its proper completion.

1. **Joint Powers Agreement.** Members of the Diversion Authority (i.e. the "public authorities") will execute a Joint Powers Agreement amongst themselves, which will establish their joint authority and assign the power to act on behalf of the group to one member of the Diversion Authority. *See* N.D.C.C. § 54-40, *et. seq.* For purposes of this outline, let us assume that the CCJWRD will be the one member assigned the authority to act on behalf of the group. Accordingly, the CCJWRD will be responsible for negotiating and administering the Development Agreement with Build Co., as well as any related lease or rental agreements. *See* N.D.C.C. § 48-02.1-11. It is envisioned, that the Diversion Authority would maintain control over policy decision making.
2. **Special Assessment Bond.** In conjunction with the other initial steps in this process, CCJWRD will issue special assessment bonds. The proceeds of these bonds would be delivered to a trustee, who would be charged with the task of receiving, processing and

¹ *See* "New law establishes office to facilitate public-private partnerships" article on Minnesota Department of Transportation's website at <http://www.dot.state.mn.us/funding/innovative/article6.html>.

² *See id.*

paying invoices to the private developer and to the various public entities which have costs associated with the F-M diversion. Cass and Fargo sales tax proceeds would be sent to the trustee who would first apply the proceeds to the debt service on the CCJWRD special assessment bond and then into a Lease/user fee account. The Lease/user fee account would have both a reserve account and an annual payment account.

3. **Acquisition of Property.** Using its eminent domain powers CCJWRD will finish acquiring the real property needed to complete the F-M Diversion Project. *See* N.D.C.C. § 48-02.1-05.
4. **Non-Appropriation Lease.** CCJWRD, on behalf of the Diversion Authority, will lease the acquired property (and right of way) to Build Co. under a Non-Appropriation Lease. *See id.* The lease term would be for the statutory maximum of fifty (50) years. N.D.C.C. § 48-02.1-06. It is mandatory that the lease be reviewed every five years and amended if necessary. *See id.* Lease payments would be payable out of the Lease/user fee account. Once the CCJWRD district special assessment bond is redeemed, then additional funds would be available in the Lease/user fee account to prepare the lease payments or to continue making annual lease payments.
5. **Development Agreement.** CCJWRD, on behalf of the Diversion Authority, along with USACE, will enter into a Development Agreement with Build Co. Under the Development Agreement, Build Co. will agree to build, design, finance, and operate the F-M Diversion Project in exchange for “rental payments.” There will be many components to the Development Agreement. Below is an overview of the key provisions and arrangement of the contract.
 - 5a. **Design-Build-Finance-Operate (DBFO).** There are a variety of ways to structure a PPP arrangement. The arrangement that seems the best fit for the F-M Diversion Project is an arrangement known as a “Design-Build-Finance-Operate (DBFO) contract,” the primary arrangement for new systems that may take more than 20 years to complete (like a river diversion). *See* Chasity H. O’Steen & John R. Jenkins, *We Built It, and They Came! Now What? Public-Private Partnerships in the Replacement Era*, 41 Stetson L. Rev. 249, 275 (2012). The private operator is very involved in a DBFO contract, often shouldering responsibility for all (or most) of the design, construction, operation, maintenance, and financing of the project. *See id.* The public authority’s only major responsibility is to obtain funding for rental payments made to the private operator (here, Build Co.). The DBFO contract model would be used as a starting point for structuring of the Development Agreement.
 - 5b. **Down Payment to Build Co.** Given its large undertaking, Build Co. will likely demand a significant down payment at the start of construction. The down payment to Build Co. shall consist of all of the bond proceeds received from the issuance of special assessment bonds. These proceeds (and other payments) shall be deposited with a professional trustee (e.g., U.S. Bank), who will manage the funds and disperse money to Build Co. in installment payments as construction progresses (*see* Step 6 below).

5c. **Security Provisions.** In exchange for assuming the risk of non-appropriation of funds, Build Co. will be granted the following security interests:

- (a) A first lien against any yearly payments made by the USACE to the Diversion Authority;
- (b) A first lien on “shadow user fees,” that is, any excess sales and use tax generated in Fargo and Cass County that surpasses the amount of principal and interest required to repay the special assessment bonds;
- (c) The right to keep any revenue it is able to generate from sub-leasing³ portions of the leased property for farmland or recreational purposes; and
- (d) A guarantee from Fargo and Cass County that these two public authorities will use their best efforts to make lease payment appropriations to Build Co. after the special assessment bond is retired (in years 31 to 50).

5d. **Mandatory Terms.** North Dakota’s PPP Laws require that the Development Agreement contain certain mandatory provisions. *See* N.D.C.C. § 48-02.1-09. A majority of the mandatory terms relate to safety and compliance with building/construction rules. One term requires that “the anticipated fees, rental income, and revenues from the operation of the facility, or other sources of funding, or any combination thereof, be sufficient to pay the maintenance and operation costs for the facility, and principal of and interest on any evidence of indebtedness to finance the facility.” N.D.C.C. § 48-02.1-09(5).

5e. **Other Terms.** Some other key terms of the Development Agreement may include:

- (a) Build Co. will likely demand some form of indemnification from the public authorities involved in this transaction, but any indemnification provided by the public authorities will be limited by statutory caps placed on the liability of public entities;
- (b) As previously discussed, Build Co. will need to provide assurances that it will see the project through to its completion, including evidence of financial security and a capacity for longevity.

6. **Custodian Trustee Agreement.** CCJRWD and Build Co. will enter into a Custodian Trustee Agreement with a professional trustee (e.g., U.S. Bank), who will manage any “rental payments” or other funds to be paid to Build Co. The trustee will disperse money to Build Co. in installment payments as the construction progresses. A Custodian Trustee Agreement is mutually beneficially to both parties, as it provides assurance to Build Co. that its future payments are being securely managed and convenience the Diversion

³ The Development Agreement will include standard restrictions on Build Co.’s right to sub-lease. For example, Build Co. would be prohibited from sub-leasing property for purposes that could create environmental hazards on the property or pose other risks to the F-M Diversion Project.

Authority, who will simply deposit all payments with the trustee who takes care of the rest.

7. **Final Certification.** At the completion of the F-M Diversion Project (i.e. satisfaction of all duties and obligations under the Development Agreement) and termination of the lease agreement between the parties, the parties should execute a final Certificate, whereby Build Co. agrees to release any and all liens on the Project and CCJWRD assumes total control and responsibility for the improved area. There may need to be some discussion about this.