The joint subcommittee studying public-private partnerships related to seaports in Virginia held its fifth meeting on August 12, 2009. The legislative members in attendance were Chairman Purkey, Senator J. Miller, and Delegates Cosgrove, A.T. Howell, and Massie. Messrs. Godfrey, Milliken, Moye, Padgett, Sisco and Taylor were the nonlegislative members in attendance.

Paul D. Fraim
Mayor
City of Norfolk

Mayor Fraim delivered remarks as a representative of cities that host seaports and suggested that the citizens of Norfolk have standing to be represented in discussions about the future of Virginia's seaports.

The mayor first argued that if privatization occurs, host cities should be treated fairly and equitably for costs they have incurred. He stated that because the Constitution mandates state responsibilities (prisons, schools) which do not include economic engines such as seaports, then host cities should be compensated. Moreover, Mayor Fraim expressed concerns about private port operators being granted tax-exempt status because a grant of such status would prevent host cities from collecting revenue from such private port operators.

The mayor further addressed the argument that cities benefit economically from having seaports located within their jurisdictions. Countering such argument with three points, the mayor first argued that just because a port is located in a particular city does not mean that city will reap the significant benefits of the port being located there. Second, the mayor referenced data that host cities lose more revenue because of unreimbursed municipal services given to ports (e.g., extra police, road construction, etc.). Third, the mayor stated that no one has shared why, as to date, the ports need to be privatized.

Finally, the mayor argued that the Public-Private Transportation Act was never designed to address the privatization of the Commonwealth's seaports.

Ashley S. Colvin
Project Leader
Joint Legislative Audit and Review Commission

Mr. Colvin delivered a presentation entitled "Lessons Learned from Public-Private Partnerships." His presentation centered on two issues: (1) the variation of legislative oversight of public-private partnerships and (2) lessons learned from selected public-private partnerships. First, Mr. Colvin discussed the legislative history of the Public-Private Transportation Act and the Public-Private Education Facilities and Infrastructure Act. Next, Mr. Colvin discussed the Public-Private Partnership Advisory Commission's mission, membership, and relationship with the Joint Commission on Transportation Accountability. He then explained that the vendor's experience on similar projects and understanding of the public entity's business from an operational perspective are key elements for success. In addition, Mr. Colvin commented that such a public-private "partnership may still require public role and support," including the need for public moneys to be expended on partnership and the need by a public entity to have an "experienced staff." Furthermore, Mr. Colvin listed several factors to consider in evaluating proposals, including (1) the proposal may identify a need, but the public entity may be able to provide services without a partnership, (2) problems with a proposal's feasibility may not come to light until completion of agreement, and (3) budget flexibility may be lost if long-term financial commitment is made to the private partner. Furthermore, he noted that there is implicit tension between the executive branch and the legislative branch over partnership projects because the executive branch is authorized to solicit, negotiate, and implement proposals, but there is no traditional role for the legislature in the approval process. As such, Mr. Colvin suggested that a role should exist for legislative financial auditing and performance evaluation including a defined role in a public-private partnership agreement for legislative auditors (JLARC and APA) to evaluate and audit the project periodically.

Pierce R. Homer
Virginia Secretary of Transportation
Office of the Secretary of Transportation

The Secretary's presentation centered on the Commonwealth's port and Public-Private Transportation Act (PPTA) priorities. The three main priorities include (1) the promotion and realization of benefits of continued economic growth; (2) the provision of surface transportation to serve community and port; and (3) the addressing of community impacts of the ports. The Secretary later stated that such priorities present the both an economic opportunity and "a transportation challenge.

Next, the Secretary discussed Virginia's public-private partnership transportation program. First, the Secretary stated the program has several components, including special taxing districts and tolling revenues. Also, the program's goals are shared goals with other components of [the] Commonwealth's transportation program and include less cost, timeliness, accountability, and private risk sharing. Second, the Secretary explained certain current requirements of the PPTA, including the requirement of private sector commitments and the rejection of unsolicited bids that do not include private risk. Third, Secretary Homer discussed and gave examples of PPTA concession payments; some examples included support[ing] other transportation projects in corridor and increasing access or mobility within the project scope. Fourth, the Secretary gave an update on the status of several PPTA construction projects, including four construction projects that have been cancelled or withdrawn since 2002, and three projects that are currently under negotiation.

Finally, Secretary Homer explained how the proposals to privatize Virginia's seaports are and will be handled under the PPTA. The Secretary also informed the subcommittee members that included in their handouts are overviews of the proposals to privatize Virginia's seaports under the PPTA and a chart comparing such proposals. He further emphasized that the independent review panel (i) will be constituted and will serve as an advisory body; (ii) will hold public meetings, receive formal public comments, discuss proposal[s] and make a recommendation to the Virginia Port Authority (VPA) and the Secretary of Transportation on whether to advance the PPTA process; and (iii) may recommend to advance all or none of the PPTA proposals to the detailed proposal phase. However, Secretary Homer stated that the VPA must take affirmative action to request a detailed proposal, and execution of a comprehensive agreement would require successful submission of a detailed proposal and subsequent negotiation of [a] comprehensive agreement between [the] VPA and a private entity.

Dr. James V. Koch
President Emeritus and Board of Visitors Professor of Economics
Old Dominion University's College of Business and Public Administration

Dr. Koch delivered a presentation entitled "Some Issues Worth Thinking About Re: The Operation of Virginia Port Authority Terminals." Immediately below in quotations is the text of his presentation prepared for the subcommittee meeting.

"First, let me establish that I regard the privatization of port operations in Virginia as a very discussable idea. I suggested this in an opinion piece in the *Virginian-Pilot* on 24 June 2007. After all, portions of 35 ports in the U.S. are privately operated. Fifty-six percent of twenty-foot equivalent units (TEU) internationally are handled in ports with private operators. This tells us that we should look closely at proposals for privatization of port operations. But, God is in the details on matters such as this. And, the most important details in the three outstanding proposals are largely unknown to the public at large, including me. The three proposals need to be laid side by side with a fourth option---not accepting any of them and keeping the port. We need to project current arrangements forward 60 years and rigorously evaluate how valuable this would be for Virginia. If such a study already has been done, then it has not yet been made public."

Dr. Koch remarked that, "[l]et's recognize that the VPA and Virginia International Terminals enjoy good reputations and other port authorities often voice envy for Virginia's current organizational quasi-public structure, operational skill and relatively smooth labor relations. Hence, there must be observable, countable benefits that are greater than costs if we are to change things. There are some basic issues and principles that we should consider as we arrive at what would be a momentous decision with profound implications for the future."

Dr. Koch then listed the following as "possible benefits from private operation:" reduction of costs, increase in "cargo throughput speed," increase in "business volume (private operator can attract new business," stimulat[ion] of "Virginia businesses," attract[ion] of higher value cargoes," "additional investments in equipment and infrastructure," and "additional tax payments." However, Dr. Koch also noted that, "we also need to recognize that much international cargo today is not really in play. [For example, it's] 3470 miles from London to New York City, but 3743 miles from London to Norfolk. NYC always will have a locational advantage for certain types of cargo coming from Northern Europe. Private operation will not change this. New Orleans always will have certain advantage with respect to grain and Miami with respect to the Caribbean. Hampton Roads is well situated for coal shipments. Most bulk cargo traffic is unlikely to change ports in the absence of major changes in economic circumstances. TEU traffic is different, though my guess is that perhaps only one-third of TEU traffic may actually be movable from one port to another without major changes in current economic circumstances (primarily costs)."

Rhetorically, Dr. Koch asked and answered, "Can a private operation/partnership…"

1. "<u>Lower costs</u>? Perhaps."

"In order to earn a respectable rate of return on its investment, will a private operator have to raise prices and fees? One must ask in a straightforward fashion--- precisely how will the private operator make money on its investment? And, if it is the form of higher prices and fees, is it Virginians or non-Virginians who will pay? From the standpoint of Virginia, it should matter *who* pays."

2. "<u>Increase[] speed/efficiency</u>? This certainly is a possibility, but how will this occur? Smarter workers, better managers, better equipment, improved intermodal infrastructure?

Such improvements do not happen via magic. What precise investments in workers, managers, equipment and infrastructure will the private operator make? When will these occur?"

3. "<u>Icrease[] Volume of Business</u>? There is some evidence from other ports that certain private operators can bring some business from specific carriers with them. What have our three bidders promised?"

4. "<u>Stimulate Virginia Business</u>? To the extent that a private operator lowers costs, increases speed, and improves infrastructure, Virginia businesses and their customers will benefit. Employment will increase and customers will pay less for items ranging from automobiles to bananas. Tax collections will rise. However, are prices and fees going to increase over the years and, if so, how much and when?"

5. "<u>Attract Higher Value Cargoes</u>? The theory here is that high value cargoes spin off more jobs with higher wages. Bulk cargoes historically haven't required as much labor and probably don't qualify here. Further, once we are talking about TEUs, it's not so clear that a TEU with pricey technology items will generate more economic smoke than a TEU filled, say, with cotton socks. Regardless, can a private operator help VPA attract higher value cargoes?"

6. [Attract]"<u>[i]nvestments in Port Equipment and Infrastructure</u>? Most of the desirable cost and speed developments just discussed depend upon significant port investments.

How much are they? When? How long will they last? Who owns them? Do they require matches and complementary investments from the Commonwealth (e.g., in highways and bridges/tunnels)?"

Next, Dr. Koch commented that, "looming above all this is the degree of risk," and "evaluat[ed] systemic vs. non-systemic risk." Moreover, Dr. Koch stated that "[w]e've learned over the past year that the world is a much more risky place than many believed. There is *systemic* (economy-wide) risk and *non-systemic risk* (associated with a specific firm or operator) that Virginia must take into consideration. When the entire world economy goes into the ditch (this is systemic risk that we can't control), then port traffic and business are visibly diminished. [For example,] Hapag Lloyd of Germany (sixth largest container fleet in the world) is attempting to obtain an emergency $427 m. loan to stay afloat and another $2.0 b. in capital to ensure future survival." Dr. Koch cited "continued world-wide economic decline" and the "declining real value of the U.S. dollar" as "systemic risks we face in Virginia."

The fate of the U.S. dollar was next discussed. Dr. Koch asked, "[w]hat will happen to the value of the U.S. dollar?" and replied that "[t]he value of the U.S. dollar has been tanking. Will this be true for 60 years? That's unlikely. However, for the next few years, the value of the U.S. dollar is quite likely to suffer because of: (1) the huge deficits the U.S. Government is running that require it to borrow literally trillions of dollars; and, (2) significant increases in the money supply." However, he suggested that "t]he Federal Reserve will have to be very timely and very clever for this huge surge in liquidity not to result in significant price inflation in the future." Dr. Koch also cautioned that "[f]uture revenues received from a private operator may not be worth very much."

Finally, Dr. Koch addressed the "non-systemic risk (private operator risk)" by first supposing that "the Commonwealth contracts with a private operator to run its ports" and secondly, asking, "[w]hat is the chance that this firm will do one of the following?"

1. "Go broke?"
2. "Default?"
3. "Commit fraud?"
4. "Not meet performance standards?"

A few years ago, prior to the insolvencies of firms such as Lehman Brothers, Merrill Lynch, and AIG, we might have been inclined to say *“the chances of this are almost zero.”* We now know that these things can and do happen. Our port evaluation must take this into account. One of the ways we do this is via 'discounting.'" "Discounting is the process of taking into account the reality that money one has in hand today is worth more than money that one won’t receive until, say, 10 years from today."

According to Dr. Koch, "the bottom line" is that "[t]here is a sufficiently attractive price and there are sufficiently attractive conditions that would make the privatization of port operations an attractive proposition for the VPA and Virginia. Virginia needs a rigorous assessment of the three proposals versus the unstated fourth option---keeping the ports. The degree of uncertainty and risk involved, however, are substantial for all *four* options. (Rhetorically, he asked,) Who can predict what conditions will be 40 or 60 years from today? Who among us would have predicted that last year oil prices would rise to $147 per barrel and then fall below $40 per barrel? "

Jo Anne Maxwell
Senior Assistant Attorney General/Section Chief for Transportation
Office of the Attorney General

Because the Public-Private Transportation Act had been discussed, in detail, by Secretary Homer, Ms. Maxwell answered questions posed by subcommittee members. First, Ms. Maxwell informed the subcommittee that a responsible public entity involved in a proposed PPTA project is responsible for paying for legal counsel/attorney fees incurred in negotiating the partnership agreement. Second, Ms. Maxwell stated that while the Office of the Attorney General (OAG) takes into account input made by the responsible public entity, the OAG is responsible for appointing outside legal counsel to represent a responsible public entity involved in a proposed PPTA project. Third, Ms. Maxwell stated that, generally, the Virginia General Assembly has no role in a PPTA project; however, she stated that when there is an outright sale of an asset, the responsible public entity must notify the General Assembly.

Next Meetings:

Chairman Purkey stated that the subcommittee will attempt to meet in September, October, and November.