
Legislative Frameworks and Oversight of Public-private Partnerships for Transportation

**Presentation to the
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Executive Summary

Governments across all levels in the United States recognize a need to increase the level of investment in transportation; however, there is ongoing debate as to how best to fund that investment. Recently, there has been an aversion to raising taxes on the state and federal level to fund this increased level of investment; therefore, there is a growing interest in turning to the private sector to assist in the financing of infrastructure through public-private partnerships (P3s).

Currently, there are 25 states that have some form of legislative authorization for P3s. Of the 25 states that have authorized P3s, 4 have some form of legislative approval. In Maryland, the P3 program is established and guided by a patchwork of regulations, Attorney General's opinion, and statute. Certain proposals include limited legislative oversight before a proposal is issued and awarded through the Board of Public Works. Given lack of clarity regarding the legislature's policy stance on P3s or any form of legislative oversight to protect the public interest, the legislature should consider developing a policy stance and a comprehensive framework.

The Department of Legislative Services (DLS) recommends that should the General Assembly determine that P3s are an appropriate mechanism for enhancing transportation infrastructure, there should then be a comprehensive statutory framework enacted in the Transportation Article that allows for the Maryland Department of Transportation to enter into specified P3s. The framework should also include policy

parameters expressing the legislature's intent on specific issues that would be included in a contract such as toll rate increases, revenue sharing, public input, how any proceeds from a P3 should be allocated, and other potential issues. DLS would also recommend that the General Assembly, once it has defined its policy parameters for a P3, consider a legislative authorization process for a P3 project either at the beginning or end of the process, and continue to be notified of specific financial parameters once an agreement is reached.

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Legislative Frameworks and Oversight of Public-private Partnerships for Transportation

Introduction

In recent years, the federal government and states have been averse to funding transportation infrastructure through tax increases, in part due to rising gasoline costs. Interest in utilizing private sector financing has developed as a way to expand and maintain the nation's transportation infrastructure. These arrangements with the private sector are known as public-private partnerships (P3s) and are a relatively new phenomenon to the United States. They are not simply limited to transportation but can extend to such areas as lotteries or school construction for example.

P3s have a longer history internationally. For example, toll road concessions started in Spain in the 1960s; however, P3 arrangements increased dramatically in the past 25 years. Internationally, transportation finance tends to rely more heavily on private investment compared to the United States as other countries do not have a motor fuel tax dedicated for transportation projects. Based upon the literature, the movement to P3s internationally may also be attributed to a broader expansion of privatization in the early 1990s and recognition that the public sector could either not afford or could not deliver the necessary transportation infrastructure in a timely manner. The presence of P3s is strong in Europe, particularly in England where the government in the early 1990s went through an effort to privatize government operations to create efficiencies for taxpayers.

According to a Federal Highway Administration report, since 1985 there have been 2,096 P3 public works projects at a cost of \$887.4 billion planned and funded worldwide. Of the total number of projects, a little over 50% have been completed since 2004. Overall, the international experience with P3s has been successful in the sense that the private sector has not defaulted on its contract and citizens have continued to use the roadway.

Purpose

The purpose of this paper is to help the legislature establish policy parameters, based on best practices, **before** P3 proposals are implemented in Maryland. Areas of focus included:

- the importance of legislative oversight and other states experiences;
- Maryland's current process for legislative oversight;
- best practices for a statutory framework;
- policy issues; and

- conclusion and recommendations.

The Importance of Legislative Oversight and Other States Experiences

Little is known regarding the long-term impact and effect of P3s on developing and expanding transportation infrastructure. Whether public entities that have entered into these agreements have sufficiently capitalized on their assets and received a favorable rate of return is still an outstanding question. Ensuring that the public interest is protected is an important policy issue that needs to be contemplated by the State. One manner in which the public interest can be protected is to develop a process whereby an independent body, like the legislature, has the opportunity to review and/or approve a potential P3 agreement, which is a contract that is executed between the Executive Branch and the private entity.

Using the Federal Highway Administration's database of states that have authorized P3s, only 4 of 25 states that have authorized P3s have a statutory process for legislative approval. Other forms of legislative oversight are reflected in:

- legislative notification requirements;
- the legislature's role in appointing members to boards which are responsible for approving contracts; or
- authorizations for a certain number of projects/pilot programs.

Legislatures have also included policy directives in their authorizing statutes, such as limits to the length of an agreement and use of excess funds, as a way to influence and exert oversight over P3 agreements. Following is a summary of the research as well as other observations from what other states have included in their statutory frameworks.

Legislative Approval

Several states have developed processes to provide legislative or public input into P3 agreements. **Exhibit 1** highlights the four states that have an explicit statutory legislative approval requirement. Legislative approval can occur before or after an agreement is entered into. For example, Indiana, and Tennessee each require an authorization before entering into a P3 or have authorized only a set number of P3 projects. Florida and Delaware also have developed different legislative approval processes depending on whether or not a project has been solicited or unsolicited by the department of transportation. Of note is that Florida and Indiana, each of whom require some form of legislative approval, have each entered into some form of a P3 agreement.

Exhibit 1
States with Legislative Approval Requirements

| <u>State</u> | <u>Legislative Process</u> |
|------------------|--|
| Delaware | <i>Unsolicited projects</i> must be approved or rejected by the co-chairs of the Joint Bond Bill Committee. <i>Solicited projects</i> may be reviewed and agreements entered into by the Secretary, provided that the project has been specifically authorized by the General Assembly. |
| Florida | <p><i>New Projects:</i> Legislative approval is evidenced by approval of the project in the department's work program. In addition, if the terms of an agreement exceed 75 years, then it must be specifically approved by the legislature.</p> <p><i>Lease Agreements:</i> The analysis of any lease should be provided to the Legislative Budget Commission for review and approval prior to awarding a contract on an existing toll facility.</p> |
| Indiana | After August 1, 2006, a P3 agreement for a toll road requires passage of an authorizing statute. |
| Tennessee | Current law authorizes two pilot projects for tollways. If the department tries to enter into an agreement not within the pilot program, then the General Assembly has to authorize the project through annual funding recommendations. |

Source: Department of Legislative Services

Legislative Oversight

There are other ways that legislatures can have oversight of P3 agreements. Following are four examples:

- ***Notification and Information to Legislature:*** Several states do not require legislative approval of a P3 agreement; however, statute requires notification to specified legislative committees, similar to the process Maryland currently has in place. For example, Georgia requires that a report with a proposed letter of intent to negotiate be provided to the House and Senate Transportation Committee; however, their approval is not required. Utah requires reports to the legislature on the status and progress of a toll way subject to a P3.
- ***Authorizations/Pilot Programs:*** Four states have limited the number of projects that can be completed either through the use of a pilot program or by simply authorizing a specific number of projects. An authorization for a project can imply a tacit approval from the legislature of agreements that may eventually be reached.
- ***Appointed Members to Transportation Commissions:*** While not a direct form of oversight, several states require state transportation commissions, with some members appointed by the legislature, to approve P3 agreements. For example, Alaska has a transportation commission that must approve a P3 agreement. Its members are appointed by the legislature.
- ***Policy Decisions Defined in Statute:*** In some cases states may not have required legislative approval or notification of a P3; however, the authorizing statute indicated specific policy parameters for a P3 agreement. For example, Colorado has limited concessions to 99 years, Indiana has limited concessions to 75 years, Delaware and Texas have limited toll concessions to no more than 50 years, and Florida has set a limit of 30 years.

Other states have also defined in statute how future toll increases are to be calculated or considered. Several states used broad language that indicated the agreement should allow for a “reasonable” rate of return for the private entity through toll increases. Other states were more explicit in defining future toll increases. For example, Florida requires a revenue sharing agreement and that future toll increases shall be indexed to the consumer price index or some other inflationary measure.

In some states, the authorization for P3s was quite simplistic and in other states, the authorization was quite comprehensive. Typically, the most comprehensive statutory authorizations came from states like Indiana, Texas, and California which have entered into P3 agreements. These states appear to have developed their framework in response to a specific proposed project rather than proactively establishing broad policy parameters.

Maryland's Current Process for Legislative Oversight

Maryland's current P3 framework is based upon an Attorney General's opinion from 1996 and Maryland Transportation Authority (MDTA) regulations. Current statute provides that the legislature is to be notified 45 days before a solicitation is issued and before a contract is approved by the Board of Public Works with specified financial information to be included. This provision in statute does not represent a broad statutory framework for P3s or a clear process for legislative oversight and approval. MDTA regulations for the P3 program include provisions for performance milestones and require that the maximum rate of return to the private entity be negotiated as part of the agreement.

During the 2008 session, House Bill 1238 (failed) would have defined P3s and established stronger legislative oversight of any proposals through either MDTA or the Maryland Department of Transportation (MDOT).

Best Practices for a Statutory Framework

Based upon the research of other states' legislative oversight of P3s as well as literature on P3s, there is an evolving statutory best practices framework. Following is a summary of some of the major points:

- ***Definition of a P3 Project:*** The first step in any statutory framework is to define what a highway P3 agreement is and what projects fall under the P3 umbrella. Other states have developed comprehensive and useful definitions of P3 agreements and the type of projects involved.
- ***Rate Setting Authority:*** Several states have attempted to address the issue of how future toll rates are set and how much they can increase over time. Some states have completely turned rate setting authority over to the private entity, while others have developed a process where a commission or the state would have approval of a toll rate increase. In terms of how much the toll rate can increase, some states have linked future toll increases to inflation or have indicated that toll rates should allow for a "reasonable rate of return" for the private sector.
- ***Length of Agreement:*** Rather than allowing the department and the private entity to determine the length of any long-term lease/concession agreement, the legislature may define in statute the maximum length of an agreement it believes is appropriate. The literature has indicated that shorter-term agreements (50 years and less) are better for the public interest. Several states have defined the maximum term of a lease as anywhere from 33 to 90 years.

- ***Noncompeting Clauses:*** Several states have inserted statements prohibiting the use of noncompete clauses. In an effort to maximize the use and profit of a leased facility, the private sector has in the past negotiated noncompete clauses. This means that the state or local entity is not allowed to develop or even enhance roadways in the vicinity of the leased roadway. As a result, the feeder transportation network to the leased facility becomes antiquated and does not serve the best interests of the public.
- ***Revenue Sharing:*** A majority of the P3 leasing agreements that have been completed in the United States have involved an upfront lump sum payment. Another option that is increasingly being recommended is to forgo the large upfront payment for a revenue sharing arrangement that would provide for an ongoing revenue stream to the state over the term of the agreement. This arrangement would compel the public and private sectors to work together to maximize revenue over the length of the agreement while also protecting the public's interest. Another option is a hybrid of the first two where there is a smaller upfront lump-sum payment as well as ongoing revenue sharing.
- ***Use of Funds:*** Of the 25 states that have authorized P3s, 11 of those states have clearly indicated that any revenue derived from a P3 is to be used for transportation-related purposes.
- ***Solicited and Unsolicited Projects:*** An unsolicited project policy opens the process to allow the private sector to submit ideas for potential P3 agreements. The benefit to opening the process is to identify opportunities that may not otherwise have been considered. The downside to opening the process is that states may become overwhelmed by solicitations, many of which may not be viable or complement the state's transportation plan.
- ***Local Government and Public Input:*** A small number of states that have authorized P3s have outlined a process for local government involvement which ranges from the opportunity to comment on an agreement to veto authority. In the case of Delaware, the relevant Metropolitan Planning Organization has 45 days to approve the project once approved by the Transportation Commissioner. In Minnesota, "a governing body of a county or municipality through which a facility passes may veto the project within 30 days of approval by the commissioner." In addition, several states provided that local governments are allowed the opportunity to provide comments on a project or agreement. Other states have also developed a hearing process where the public would have the opportunity to respond to a proposed agreement. In some states, there were also independent bodies that had to review a proposal before any final agreement could be reached.

- **Financing Sources:** The financing arrangements for P3 agreements are sophisticated and complex. In many cases, these deals may require some form of state investment. Other states have either limited the types of state financing for a P3 agreement or prohibited state involvement. Should the private sector acquire the financing necessary for a deal through the private markets, this is a likely indication that the agreement does not make financial sense for either the private entity or the state.

There are a number of other elements that could be considered as part of a comprehensive framework. These could include the following:

- eminent domain;
- property tax exemptions;
- police jurisdiction;
- ongoing contract oversight;
- remedies in case of default by the private sector;
- appeal process;
- union and minority business enterprise involvement;
- ongoing maintenance requirements; and
- legislative reporting mechanisms

Policy Issues

While MDOT has indicated that there are no plans currently underway to move ahead with a P3, it is a financing mechanism that is likely to be used in the future given current and future revenue constraints. In anticipation of the future use of a P3, there are several issues that the General Assembly should consider:

- **Need for Statewide Policy:** The General Assembly has not clearly indicated its position regarding the role of P3s as an option for transportation finance. Currently, P3s are allowed due to regulations that were reviewed by a joint legislative committee, an opinion of the Attorney General from 1996, and a statutory provision regarding reporting requirements. Combined, these individual components do not represent a clear

expression of intent from the entire legislative body that P3s are an appropriate financing tool for transportation infrastructure in the State. Given the recent introduction of P3s into the United States, their complexity, and long-term uncertainty, the legislature should indicate its policy preference clearly in statute.

- ***Need for Comprehensive Framework:*** Should the legislature determine that P3s are appropriate mechanisms for financing and expanding the transportation network, there should also be a statutory framework. Of the 25 states reviewed, Maryland was the only State that did not specifically provide a statutory authorization for P3 agreements. The benefit of a statutory framework is that there is no longer any ambiguity regarding the legislature's position on P3s and MDOT and MDTA have clarity prior to moving ahead with a solicitation. A statutory framework should also be comprehensive in nature to adequately address the ancillary issues that arise with a P3.
- ***Establish Parameters Before Agreement Is Reached:*** In doing research on legislative oversight of P3s, it was noted that the states that had the most comprehensive statutory frameworks for P3 agreements were states that developed their framework in response to a proposed P3 agreement. States that provided for a statutory authorization for P3s prior to an agreement being reached conversely often did not include policy parameters or consider specific policy issues in the authorizations. By not indicating policy parameters prior to an agreement being reached, legislatures defer to the Executive Branch to protect the interests of the state and taxpayers. The legislature in its role as a check and balance in government, can exercise legislative oversight of P3s and protect the interest of the state and taxpayers by establishing the parameters for a P3 agreement before an agreement is reached. Legislative parameters could include direction regarding the length of a P3 agreement, the extent of future toll increases, expectations for the ongoing operation of a facility, or a desire for a revenue sharing arrangement rather than a lump sum payment.
- ***Legislative Authorization:*** As was noted earlier, of the 25 states that have a statutory P3 authorization, 4 states have some form of legislative approval. Legislative approval or authorization of a P3 could take on several forms. For example, the legislature could authorize a specific project or pilot project before an agreement is reached. The alternative to an authorization for a project before an agreement is reached would be to require legislative approval once an agreement has been reached. This type of approval allows the legislature to fully understand the financial and operational implications of an agreement. Legislative authorization of a project can occur at the beginning of the process before a solicitation for a project is issued, once an agreement is reached, or at both the beginning and the end of the process. Should the legislature determine that a legislative authorization process is warranted, when that authorization should occur, is also an important consideration. A legislative authorization process ensures that the legislature has input into a specific project or agreement.

- ***Responsibility for the P3 Program:*** Maryland's P3 program is operated by MDTA. MDOT modes such as the Maryland Port or Transit Administrations may also become involved in a P3 arrangement; however, MDTA is the administrative agency and liaison for the private sector. MDTA is responsible for the toll roads, bridges, and tunnels in the State and not necessarily other transportation facilities. Given that MDTA has a singular focus as opposed to MDOT which has oversight over all modes, and to a great extent the State's transportation network, having MDOT be responsible for the program would provide for a greater degree of oversight and continuity. In addition, having MDOT oversee a program provides a degree of certainty that a P3 agreement will conform to the State's long-range transportation plan.
- ***Solicited Versus Unsolicited Proposals:*** In Maryland, MDTA can only accept solicited proposals for highways. The benefit of only allowing for solicited proposals to be considered is that the State can define which projects to pursue under this financing model. For the other modes of transportation in the State, MDTA can receive unsolicited proposals for P3 projects. The potential exists that MDTA could receive project proposals that make little sense for the State to pursue and are not part of the State's long-range transportation plan. However, the benefit of unsolicited proposals is that a project may be suggested that is not part of the State's plan and does make sense.
- ***Limiting Future P3 Agreements:*** P3 agreements typically involve two types of transactions, the leasing of an existing facility (*e.g.*, the Bay Bridge) or constructing a new facility with the private entity retaining the rights to collect revenue on that facility for the length of the contract. For Maryland, the leasing of an existing MDTA facility is complicated due to the trust agreement with MDTA bond holders. It is impractical for the revenue from one of the facilities to be removed from MDTA's revenue stream unless MDTA retired or defeased its debt. To prevent any issues with the bond holders, one option would be to limit future P3 agreements to new construction. This policy would also provide certainty that future toll rates on existing facilities would be managed by the State rather than a private entity motivated by profit.

Conclusions and Recommendations

As the demands for transportation infrastructure continue and the ability to pay for those needs is insufficient, P3s may be one option that the State may want to consider as a way to expand and enhance the transportation network. Should the General Assembly determine that this is an appropriate financing mechanism, the Department of Legislative Services would recommend that the General Assembly develop and enact a broad statutory framework for MDOT to enter into P3 agreements. This framework should allow the State to utilize this financing mechanism while protecting the interests of the State and the taxpayer. As such, legislation should establish a standalone section in the Transportation Article, making MDOT responsible for administering and overseeing any public-private partnership.

This model would give MDOT broad discretion in soliciting and negotiating agreements with the private sector, within the context of broad policy parameters established in law. The Executive Branch would have flexibility, the legislature would not need to micromanage projects, the private sector would have clarity regarding State policy, and the taxpayer interests would be protected. Following are the major policy objectives the General Assembly should define initially and in doing so provide legislative oversight of any future agreement:

- ***Limit P3 Projects to State Solicited Projects or Specific Projects:*** By only allowing for solicited projects, MDOT will not be overwhelmed by project proposals from the private sector that may be superfluous to the needs of the State. Another alternative would be for the legislature to specify that P3 arrangements may only be used for a certain type of transportation facility (*e.g.*, toll facilities) or to a specific project.
- ***Limit Proposals to New Toll Facilities:*** Currently, toll facilities owned and operated by the Maryland Transportation Authority should not be part of a P3 agreement; only new facilities should involve P3s. In precluding existing facilities from a P3 agreement, the legislature can avoid issues with MDTA's bond holders and Trust Agreement involving an existing facilities' revenue stream to the pool of revenues used to pay for debt service. Another concern with leasing existing facilities for an extended period of time is that the State could underestimate the value of the asset and as a result not fully capture all available equity from the facility. From a policy perspective, the need for P3s is driven by the need to expand the existing transportation infrastructure and a lack of revenues; therefore, P3s should focus on expanding the network through new facilities and not rely on existing facilities for the financing of an expanded transportation network.
- ***Definition of an Agreement:*** The legislature should exempt transit oriented development projects from any P3 framework and focus on large projects. Any definition should at least include the leasing or construction of a new transportation facility, or significant capital improvement to an existing facility and perhaps include a dollar threshold.
- ***Legislative Authorization:*** The legislature may want to consider a process that would require legislative authorization of a P3. The authorization may come initially and require that individual projects be authorized or could come at the end of the process once an agreement has been reached by the public and private sector. Another option would be to require that legislative review of a proposed agreement must occur during a legislative session such that legislation could be enacted if necessary.
- ***Future Toll Rates:*** The legislature should develop a framework that allows for predictable toll rate increase over the length of the agreement. This could mean that future toll increases are linked to inflation, vehicle miles traveled, or another metric. There should also be a process whereby the private sector would report to the legislature on toll revenues and if the private sector's revenues exceed a certain threshold, toll rate

increases would be suspended in that year. Another option to limit future toll increases would be to specify a rate of return on its investment that the private sector could not exceed over the life of the agreement.

- ***Length of Agreement:*** The legislature should set in place a maximum length on any lease term. At a minimum, a lease agreement should not exceed 35 years.
- ***Noncompete Clauses:*** The legislature should indicate that noncompete clauses should not be part of any P3 agreement.
- ***Revenue Sharing:*** The legislature should express the desire that any P3 include annual, ongoing revenue sharing. The private sector and MDOT can determine whether or not such a revenue sharing agreement would also include an upfront lump sum payment in addition to any ongoing annual revenue payments to the State. Furthermore, the State should stipulate that it should receive a portion of any benefit or revenues derived from the private sale or refinancing of any portion of its rights and costs to a facility.
- ***Use of Funds:*** The current Maryland program for P3s does not provide where the proceeds from an agreement will go, how those funds will be used, and if the funds will be reinvested in transportation. Maryland should indicate that any funds received under a P3 are to be used for transportation purposes and/or at a minimum that the funds are to be appropriated by the General Assembly. The General Assembly may also want to consider creating a separate fund from which the proceeds are deposited and can only be withdrawn through legislation that designates specifically how the funds are to be allocated and appropriated in future fiscal years.
- ***Public and Local Government Input or Oversight:*** Toll-based infrastructure development represents a major philosophical shift in transportation finance, which the public often does not realize until programs enter revenue service. To ascertain public acceptance, a process could be developed that would allow for the public to express their opinions and views of a proposed P3 through public hearings or some other means. Another alternative would be to appoint an independent body with public membership to review proposed P3 arrangements. The legislature could also develop a process that allows for local governments to participate in the decision making process, either through a review and comment period, or approval. This may be as simple as indicating that a local metropolitan planning organization (MPO) must approve a proposed agreement or that a proposed agreement must be part of a MPO's long-range plan.
- ***Financing Sources:*** The legislature should indicate that no State funds or debt mechanisms may be used as part of the financing for a P3.

- ***Ongoing Reporting and Performance Measures:*** The legislature should require an annual report that indicates the current status of the leased facility, traffic flows, revenue, expenditures, planned maintenance activities, and safety issues. In addition, any agreement should clearly define performance measures that the private entity must adhere to and report on.
- ***Ongoing Maintenance Requirements:*** As part of the agreement, the private entity should also be required to provide the ongoing maintenance for the facility. This should include maintaining the facility at least at existing State standards with the State Highway Administration responsible for monitoring and suggesting maintenance projects. As part of the ongoing reporting requirements, there should be annual updates to the legislature as to the current state of the facility and what maintenance efforts are underway and being planned.
- ***Ongoing Contract Oversight:*** Given that P3 contracts are for an extended period there should be a process defined for contract oversight to ensure that the contract parameters are reached and that the interests of the State are continually monitored. There should also be a process identified to address any conflicts between the State and the private entity and how those conflicts are to be addressed.
- ***Police Jurisdiction and Laws:*** The legislature should also indicate that the vehicle and other laws of Maryland are applicable to any leased facility. In addition, the legislature should also indicate that State police may patrol the facility and issue citations.
- ***Remedies in Case of Default by Private Sector:*** As with any contract, there exists the potential that the private contractor could default on its contract and/or payments to the State. The legislature should outline a process should this event occur and indicate whether the State will assume ownership and operation of the facility, secure another private sector contract, or pursue other options.
- Other issues to consider include the following:
 - Eminent Domain;
 - property tax exemptions;
 - appeal processes; and
 - union and minority business enterprise involvement.

In sum, by creating a comprehensive framework that includes policy parameters, the Executive Branch can solicit any P3 project. Current statutory procedures for notification and review by the legislature could remain in place so that any proposal would receive legislative oversight or could be strengthened through an authorization process.