9.3 Houston METRO 4-Lines Project, Houston, Texas[1]

In 2005, the Texas legislature passed the Hybrid Delivery System Act, which gave the Metropolitan Transit Authority of Harris County (Houston METRO) the authority to allow private entities to act as facility providers and develop, design, construct, equip, finance, operate, and/or maintain qualifying transportation facilities. Houston METRO elected to use this new hybrid delivery process for a major expansion of its light rail system, which at the time consisted of the seven-mile Red Line running along Main Street in downtown Houston.

Houston METRO issued an RFP in August 2006, seeking a facility provider for its light rail expansion. It received three proposals, and Washington Group Transit Management Company (WGTMC) was ultimately awarded an agreement to perform certain pre-development services, including negotiating a final development agreement for the project. On April 30, 2008, after it became apparent that the parties would not be able to reach agreement on the terms of a development agreement, Houston METRO apparently terminated the agreement and began negotiations with Parsons Transportation Group, Inc. (Parsons). About a month later, Houston METRO and Parsons entered into an agreement whereby Parsons was to perform certain pre-development services while proceeding with the negotiations of a development agreement.

On April 21, 2009, Houston METRO and Parsons entered into a $1.46 billion Development Agreement for Parsons to act as the Facility Provider on the project. This contract provided for designing, building, and potentially financing and operating, and maintaining four new lines (North Corridor, Southeast Corridor, Uptown Corridor, and East End Corridor).[2] The

[1] Informational sources for Section 9.3 include senior individuals at FTA, Houston METRO and HRT, as well as internet articles reporting on this project.

[2] While the Development Agreement mentions financing, Parsons never took any responsibility of performing this activity. Likewise, as discussed in Footnote 13, while the Development Agreement mentions operation and maintenance, Parsons did not ultimately take on this responsibility, as the O&M Contract was signed directly by

lines total approximately 20 miles, along with approximately 32 stations and storage and inspection facilities. The project also encompassed a major renovation to the existing operations center and the purchase of over one hundred light rail vehicles, including some vehicles for the existing Red Line.

As might be expected, the Development Agreement reflects a complex structure that contains multiple contracting relationships. In addition to Parsons, as the Facility Provider, three entities designated as Primary Contractors have separate contracts, designated as Implementation Agreements, with Houston METRO:[3]

- Design-Build Contract: The design-builder is the joint venture known as Houston Rapid Transit ("HRT"), the members of which include Parsons, Granite Construction Company, Kiewit Texas Construction L.P., and Stacy and Witbeck, Inc. Parsons is the managing member of HRT. The Design-Build Contract was originally in the amount of $1.28 billion.

- Vehicle Supply Contract: Houston METRO determined that the light rail vehicles were to be obtained from Construcciones y Auxiliar de Ferrocarriles (CAF). The Primary Contractor for this work was Houston LRV 100, L.L.C., an entity that has CAF USA, Inc. (a subsidiary of CAF) as its economic member and Parsons as its non-economic member.

- Ownership and Maintenance ("O&M") Contract: The O&M contractor is Houston Operation and Maintenance, LLC, the initial equity of which is held 70% by Veolia Transportation Services, Inc. and 30% by Parsons.[4]

The Development Agreement makes it clear that Parsons is not a guarantor of the underlying performance of any of the Primary Contractors, and that Houston METRO retains the right to pursue any of the Primary Contractors to the extent that they were responsible for problems.

Houston METRO with Operation and Maintenance, LLC, an entity essentially owned and controlled by Veolia Transportation Services, Inc.

[3] While the Design-Build Contract and the Vehicle Supply Contract were initially entered into between Houston METRO and Parsons, they were immediately assigned, and all rights and obligations of Parsons thereunder were transferred to, HRT and to Houston LVR 100 LLC, respectively.

[4] Other than providing its initial equity contribution and having voting rights on some major issues affecting the LLC, Parsons does not have any economic interest in this LLC, and it is, for practical purposes, owned and controlled by Veolia Transportation Services, Inc.

However, it is also clear that the success of the overall project can be affected by the cooperation of all parties involved in the project and by Parsons' efforts to integrate the schedules of the Primary Contractors through implementing processes to resolve issues and conflicts among them. In this regard, Parsons has the duty to manage, coordinate and integrate these interfaces and work activities:

> The success of the Project will . . . require joint efforts by the Primary Contractors and the Facility Provider. The Facility Provider is responsible for management, coordination and integration of the entire (p)roject until five years after the Revenue Service Date for all Facilities, and shall take appropriate steps so that all required efforts by the Primary Contractors are undertaken in accordance with the terms and conditions of (the Development Agreement), the Implementation Agreements and the Interface Agreement. The FP shall take the appropriate action to resolve conflicts and disputes between or among the Primary Contractors regarding liability for problems with the Project expeditiously, eliminating the need for Metro to involve itself in such matters.[5]

A few elements of the Implementation Agreements are worthy of note. The Design-Build Contract's $1.28 billion contract price consisted of $831 million for fixed price work, with the $449 million balance for allowances that were subject to adjustment. HRT provided a five year warranty on each LRT facility, with the overall limitation of liability on the contract being 15% of the contract price. Liquidated damages were set at $40,000 per day for each LRT facility, up to a maximum of $10 million per facility. There were also $50 million in performance incentives available to HRT under the contract. The limitations of liability for the O&M Contract and Development Agreement were 15% and 20% of the contract value respectively.[6]

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[5] Excerpted from Section 4.1 of the Development Agreement.

[6] While the design and construction of this project has been proceeding well, it should be noted that a major issue arose with respect to the LRV purchases. In September 2010, FTA concluded that Houston METRO's contract for the LRV purchases was flawed in that, among other things, it violated the Buy America Act and FTA's competition rules. This ultimately resulted in a termination of the contract with Houston LRV 100 L.L.C and a reprocurement of the LRVs for the project. On April 6, 2011, Houston METRO awarded Siemens an $83 million contract for the purchase of 19 LRVs.

As of the date of this report, Houston METRO is still awaiting FTA's approval of a Full Funding Grant Agreement for the North and Southeast Corridors, which are part of FTA's Penta-P initiative. HRT has been advancing certain early work (e.g., utility relocation) during the two years since the contract was executed through the use of LONPs, with Houston METRO directly funding this work. The LONP process has allowed the project to maintain the guaranteed completion dates. Additionally, because of local funding issues, Houston METRO totally suspended work on the Uptown Corridor.

As for performance security, each agreement contained a different approach. The Development Agreement did not require surety bonds; it required Parsons to provide a parent company guaranty. The O&M Contract likewise provided for a parent company guaranty from the parent of Veolia Transportation Services, Inc., but required performance and payment bonds in the event the O&M contractor performed any actual construction work undertaken during the performance of the O&M term. The Design-Build Contract required parent company guarantees, as well as performance and payment bonds for the first phase of utility relocation work that was to be performed prior to full notice to proceed on the overall project.

Houston METRO's decision to use parent guarantees as opposed to surety bonds was based in large measure on pre-proposal surveys that indicated the surety market could not respond to a 100% performance bond on a project of this magnitude. It believed that Texas law allowed a public agency that cannot obtain performance bonds to go forward without the bond, with the understanding that the agency took on the risk of the contractor's failing to perform or pay its subcontractors. Houston METRO concluded that these market conditions, coupled with guarantees from financially sound parent companies, adequately protected the public's interest.

The decision not to use performance bonds was widely criticized by, among others, the Texas Construction Association (which represents subcontractors and suppliers) and those involved in the surety industry.[7] The Surety and Fidelity Association of America wrote a lengthy letter arguing that Texas law mandated that bonds be supplied on the project, and that there was adequate surety capacity to cover the entirety of the construction work on the project. There were also newspaper articles that cited the risk to taxpayers for not having a bond in place.

As the project moved forward, the decision on bonding was reconsidered. By April 2010, Houston METRO and HRT had concluded major negotiations that converted approximately $400 million of allowances into fixed price work. As part of this, Houston METRO directed HRT to provide 100% performance bonds for the full construction value of the project as of the date of the full notice to proceed for the project, which was expected to be received at or about the time of the FFGA approval was expected. There was a modification to the Design-Build Contract to reflect this requirement as well as the conversion of the allowances to fixed pricing.

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[7] Texas Construction Association Quarterly, *Houston Metro Project, "Parent Guarantees",* Fall 2009.