

**FIELD HEARING ON HIGH-SPEED RAIL
ON THE NORTHEAST CORRIDOR**

**TESTIMONY
OF
J. PERRY OFFUTT
MANAGING DIRECTOR
MORGAN STANLEY & CO. INCORPORATED
JANUARY 27, 2011**

1 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A. My name is J. Perry Offutt. My business address is 1585 Broadway, New York,
3 New York 10036.

4 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

5 A. I am employed by Morgan Stanley & Co. Incorporated ("Morgan Stanley"). I am
6 a Managing Director in the Investment Banking Division and am the Head of
7 Infrastructure Investment Banking for the Americas. My group focuses on the
8 strategic alternatives for municipal assets, such as public-private partnerships.

9 **Q. PLEASE BRIEFLY DESCRIBE YOUR PROFESSIONAL AND**
10 **EDUCATIONAL BACKGROUND.**

11 A. I have a Bachelors of Arts degree in Economics from Duke University and
12 graduated Magna Cum Laude. I started working at Morgan Stanley in 1994 in the
13 Mergers & Acquisitions ("M&A") Department. In 1999, I graduated from The
14 Wharton School, University of Pennsylvania with a Masters in Business
15 Administration ("MBA") and re-joined Morgan Stanley that year. As the Head of
16 Infrastructure Investment Banking for the Americas at Morgan Stanley, I am
17 advising or have recently advised on the following transactions:

- 18 1. OHL Concesiones / Morgan Stanley Infrastructure Partners on their potential
19 bid for the concession of Puerto Rico's PR-22 and PR-5 toll roads (ongoing
20 public-private partnership)
- 21 2. City of Indianapolis on concession of City metered parking system (public-
22 private partnership closed in 2010)
- 23 3. City of Pittsburgh on \$452 million proposal for concession of City parking
24 system (public-private partnership suspended after a recent city council vote)
- 25 4. Citizens Energy Group on \$1.9 billion acquisition of Indianapolis water and
26 wastewater system (ongoing)
- 27 5. Morgan Stanley Infrastructure Partners on its acquisition of NStar's district
28 energy operations (closed in 2010)
- 29

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2 **Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMITTEE?**

3 A. No.

4 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS**
5 **PROCEEDING?**

6 A. As a financial advisor focused on public-private partnerships, I have been asked
7 to share my perspective on some of the key considerations that could affect
8 interest from the private sector (including construction companies, rail operators
9 and private investors) in participating in the design, construction, operation,
10 maintenance and financing of a high-speed rail project along the Northeast
11 Corridor (the "Project").

12 **Q. WHAT IS A PUBLIC-PRIVATE PARTNERSHIP?**

13 A. A Public-Private Partnership ("P3") involves a long-term lease (not a sale) of
14 municipal assets (the "Concession"). The specific terms regarding how the asset
15 is operated and maintained are included in a contract between the public
16 agency/government and a private sector entity (the "Concession Agreement").
17 The government retains ownership with a right to reclaim the assets if the private
18 operator does not meet certain standards. Under such an arrangement, some
19 degree of risk and responsibility is transferred from the public to the private
20 entity.

21 **Q. HOW WOULD A P3 FOR HIGH-SPEED RAIL WORK?**

22 A. A P3 can be used for new construction projects (i.e., "greenfield" projects). In the
23 case of the Project, the government entity would enter into a Concession
24 Agreement with a private entity with the skills to design, build, operate, maintain

1 and finance the proposed Project. Given all of these requirements, the private
2 entity is typically a consortium of various corporate and financial entities. Such an
3 arrangement would transfer significant risks and responsibility from the
4 government, as well as make great use of private sector expertise.

5 **Q. HAS A P3 BEEN USED FOR HIGH-SPEED RAIL BEFORE?**

6 A. While there has not been a P3 involving a U.S. high-speed rail project, there are
7 many examples of successful P3s for greenfield projects. For example, in Florida
8 the State has entered into a P3 to reconstruct the I-595 toll road and a P3 to build a
9 new Port of Miami Tunnel. Analyzing these and other similar U.S. greenfield P3s
10 can help provide guidelines for a P3 for the Project.

11 **Q. HOW DO YOU KNOW PRIVATE PARTNERS WOULD HAVE**
12 **INTEREST IN A HIGH-SPEED RAIL P3?**

13 A. Many operators are interested in high-speed rail in the U.S. given their existing
14 experience operating high-speed rail systems internationally such as in Europe
15 and Asia. In addition, many U.S. and international construction firms will have
16 interest in partnering with high-speed rail operators; such firms would play an
17 integral role in the design and construction of the proposed rail line.

1 Q. HOW WOULD WE MAKE SURE A PRIVATE PARTNER IS QUALIFIED
2 TO CONSTRUCT AND OPERATE A HIGH-SPEED RAIL SYSTEM
3 SAFELY?

4 A. Due to the many safety and security concerns associated with high-speed rail, it is
5 essential that all potential private partners undergo an extensive evaluation of
6 their qualifications. Such an evaluation is typical in P3 processes. Traditionally,
7 the procuring government entity will issue a "Request for Qualifications"
8 ("RFQ") that requires private operators to submit a response listing their
9 qualifications in the areas of design, construction, operations and maintenance, as
10 well as describe their ability to finance construction and improvements as
11 necessary. In order to be considered as a bidder for a P3, a private party would
12 need to meet all criteria to pass the qualifications phase. Consequently, the
13 government can screen which private bidding groups ("Consortiums") are able to
14 submit a final bid for a P3 of the Project.

15 Q. HOW DOES THE GOVERNMENT COMPENSATE THE PRIVATE
16 PARTNER?

17 A. If the Project generates enough operating cash flow, the private partner would be
18 compensated over time by receiving the revenue generated by fares from
19 passengers. If the Project does not generate enough revenues to cover operating
20 costs, many Consortiums will request a revenue guarantee or an ongoing revenue
21 supplement from the government to ensure that they are able to cover their costs.
22 A similar structure of ongoing government payments over the term of a P3, called
23 "Availability Payments" has been used in many U.S. greenfield toll road P3s.

1 Instead of asking Consortiums to bid the highest upfront amount, governments in
2 these examples have instead asked bidding Consortiums to submit the “lowest
3 required ongoing Availability Payment”. However, if the ridership analysis does
4 support ongoing cash flows that could generate a return to the investors, an
5 Availability Payment might not be required.

6 **Q. PLEASE DESCRIBE AN EXAMPLE AVAILABILITY PAYMENT P3.**

7 A. In October 2009, the Florida Department of Transportation (“FDOT”), in
8 conjunction with the City of Miami and US DOT, reached financial close for the
9 Port of Miami Tunnel P3. This P3 project involves the construction of a tunnel
10 under the Port of Miami at an estimated project cost of approximately \$900
11 million. The winning bidder (Meridiam and Bouygues) proposed providing \$80
12 million in equity upfront plus helped arrange \$342 million of senior financing
13 with project finance banks. Other funding was provided by a TIFIA loan. In
14 addition, FDOT pledged to make “milestone” payments throughout the
15 construction process, followed by availability payments following completion.
16 These payments from FDOT helped provide the winning bidder with comfort that,
17 despite uncertainty around the total traffic in the tunnel, the government was
18 willing to serve as a ‘buffer’ for future traffic risks. Depending on the specific
19 projected cash flows of the Project, this may or may not be needed.

20 **Q. HOW DOES THE NORTHEAST CORRIDOR COMPARE TO OTHER**
21 **PROPOSED HIGH-SPEED RAIL PROJECTS IN THE U.S.?**

22 A. Given the existing passenger rail footprint in the Northeast and high population
23 density in key urban areas, the Project would likely generate significant interest

1 from many private entities. Private investors would particularly like the fact that
2 there is significant historical information on passenger traffic due to the existing
3 rail traffic in the Northeast Corridor area and flight traffic between Boston/New
4 York and New York/Washington, D.C., which will allow them to make better
5 estimates about potential ridership.

6 **Q. DOES A PRIVATE OPERATOR HAVE BE INVOLVED DURING ALL**
7 **PROJECT PHASES?**

8 A. A private operator could be used (i) just for the initial construction phase or (ii)
9 only as operator once the rail has been developed. While the second option can
10 provide the private operator with more information on passenger traffic, involving
11 the private operator too late in the process (e.g., after the initial construction phase
12 has been completed) can present other significant downsides. For example, if
13 involved during the development and construction phase, the private operator will
14 be incentivized to focus on adjustments to the Project plans that will positively
15 impact operations going forward, such as using highest quality materials that
16 require less ongoing maintenance.

17 **Q. WHAT CONCERNS WOULD PRIVATE OPERATORS AND INVESTORS**
18 **HAVE ABOUT A HIGH-SPEED RAIL PROJECT?**

19 A. As I previously mentioned, one of the primary reasons to enter into a P3 for the
20 Project is to transfer risks of construction and operations to the private sector.
21 However, private investors will also expect some comfort from the government
22 on a few large risks associated with high-speed rail development.

1 First, private bidders will need to understand exactly how any cost overruns will
2 be addressed in the Concession Agreement, especially if they result from events
3 over which the bidder has little to no control.

4 Second, private investors will carefully evaluate the ridership estimates and
5 ongoing cash flow potential to ensure that it will allow for an adequate return on
6 their investment. If the revenue projections are not adequate, many private
7 bidders may look for a form of Availability Payments to help ensure that they are
8 not losing money by operating the Project.

9 Third, private bidders will want to understand key policy considerations. For
10 example, the choice of station locations and plans for competing transportation
11 infrastructure will affect the feasibility of the business plan.

12 **Q. DOES THAT CONCLUDE YOUR TESTIMONY IN THIS**
13 **PROCEEDING?**

14 **A. Yes, at this time.**

J. Perry Offutt

Morgan Stanley

Managing Director, Head of Infrastructure Investment Banking for the Americas

- Mr. Offutt started at Morgan Stanley in 1994. During the past sixteen years, he has focused on executing M&A/infrastructure transactions totaling over \$160 billion across various industries (transportation, power/utilities, renewable energy, and water/wastewater).
- Mr. Offutt heads Morgan Stanley's infrastructure investment banking practice for the Americas and was the lead financial advisor in the following announced transactions: Citizens Energy on its proposed acquisition of the Indianapolis water and wastewater systems (\$1.9 billion), the City of Pittsburgh on the proposed monetization of its parking assets (\$450MM), the City of Indianapolis on its parking concession, \$600MM bond financing for Chicago metered parking, Morgan Stanley Infrastructure Partners on its acquisition of NStar's district energy operations and the City of Akron on its evaluation of a P3 of its wastewater system.
- He has also served as an integral part of the following announced M&A transactions: Puget Energy on its \$6.7 billion acquisition by a Macquarie consortium, KKR/TPG on their \$45 billion leveraged buyout of TXU Corp, PSEG on its \$27 billion merger with Exelon Corp, Scottish Power on its \$9.4 billion sale of PacifiCorp to MidAmerican, Duke Energy on its acquisition of Catamount Energy, IES Industries on its three-way merger with WPL Holdings and Interstate Power to form Alliant Energy (\$2 billion), AGL Resources on its \$700 million acquisition of NUI Corp, Terra Firma on its acquisition of EverPower, Superior Renewable Energy on its sale to Babcock & Brown and PSEG on its sale of its Waterford (Ohio) and Lawrenceburg (Indiana) combined-cycle plants to AEP.
- Published in *Journal of Applied Corporate Finance*, "Infrastructure Public-Private Partnerships Re-Defined: An Increased Emphasis on "Partnerships"", July 2010
- Mr. Offutt received his BA in Economics from Duke University and graduated magna cum laude. He also holds an MBA in finance from The Wharton School, University of Pennsylvania.