

# ClientAlert

## Energy, Infrastructure, Project and Asset Finance

May 2013

### Virginia Court Declares PPP Toll Financing Arrangement Unconstitutional



In many ways, the state of Virginia's Public-Private Transportation Act (PPTA),<sup>1</sup> which allows new, innovative methods of financing from private sources to supplement state funding and public debt financing, has been a model public-private partnership (PPP) law in the United States. However, as a recent court case shows, opponents of a PPP project in the United States can use litigation to stall or derail the project—even in Virginia and even post-closing.

Based on this new case, a toll-based financing arrangement for a PPP project in Virginia may now be deemed a "tax" that would require legislative approval for the project. This could increase costs, cause transaction delays and add uncertainty to an already time-consuming and expensive process.

#### Virginia's new case

On May 1, 2013, the Circuit Court in Portsmouth, Virginia declared that an agreement between Elizabeth River Crossings OpCo (ERCO, a private contracting company) and the Virginia Department of Transportation (VDOT), which included new tolls as a central part of the financing arrangement for a US\$2.1 billion highway and tunnel project, violated Virginia's Constitution.

#### Background

VDOT had initially planned to undertake two projects that would be self-subsidized by user tolls. As the projected toll revenues from these two projects were insufficient to cover their costs, VDOT added a third project to the bundle. User fees from this third project would also partially subsidize the construction costs of the first two projects. VDOT and ERCO executed a 58-year partnership agreement (the PPP Agreement) with toll fees, to be adjusted periodically by ERCO to meet certain objectives (including a return on ERCO's investment, inflation, congestion management and retiring debt incurred by the State of Virginia and ERCO). The PPP Agreement also obligated VDOT to pay damages if certain taxes were imposed on ERCO or if competing facilities were constructed.

The City of Portsmouth and local residents filed suit against VDOT and ERCO. In an oral ruling (*Meeks v. VDOT*,<sup>2</sup> available at this [link](#)), the Circuit Court rejected the PPP Agreement's toll-based financing arrangement.

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<sup>1</sup> Va. Code, Title 59, Chapter 22, Public-Private Transportation Act of 1995 (2012).

<sup>2</sup> *Danny Meeks, et al., v. Virginia Department of Transportation, et al.*, Case No. 740-CL-12001705-00 (Portsmouth Cir. Ct. 2013).

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### The court's decision

The plaintiffs in the litigation prevailed on their motion for summary judgment with two arguments:

1. First, that provisions of the PPTA and the PPP Agreement violated Virginia's Constitution because they involve the exercise of non-delegable legislative functions, including: (a) the delegation of power to set rates and approve a return on investment, (b) the delegation of taxing power, (c) the delegation of power that abridged the state's sovereignty by restricting the state's ability to freely build highways and collect taxes and (d) a lack of adequate standards and guidelines to accompany the delegation of powers. In response, the defendants had argued unsuccessfully that: (a) the tolls were not taxes, because they did not generate revenue greater than the total cost of the project and because they are voluntary payments for a governmental service, (b) neither the PPTA nor the PPP Agreement unlawfully delegated legislative powers or surrendered the state's powers and (c) the highways were functionally interrelated and part of a single integrated project.
2. Second, that VDOT had no authority to execute a contract unless the legislature empowered it to do so, as neither the PPTA nor other legislation allows VDOT to include provisions compensating ERCO if taxes are imposed or competing facilities constructed. They argued that these provisions, which are anti-competitive, must be clearly supported by the legislature. In response, the defendants had contended unsuccessfully that the contested contract provisions were not ripe for litigation.

The Circuit Court determined that the tolls constituted taxes that VDOT and ERCO were unauthorized to impose and that VDOT lacked the legislative authority to include provisions compensating ERCO if taxes were imposed or competing facilities were constructed, because those provisions would abridge state power.

### Next steps

These proceedings will continue for a while. On May 21, the Circuit Court issued a final order and denied VDOT's request for a stay on the ruling pending appeal. VDOT filed an appeal with the state Supreme Court on May 23.

It is unclear whether the state Supreme Court will rule on the matter prior to the scheduled commencement of tolling on the tunnel in January 2014.

At the same time, another Virginia case (*Corr v. Metropolitan Washington Airports Authority*<sup>3</sup>) is currently on appeal before a US federal court: the Fourth Circuit Court of Appeals. In *Corr*, a different Virginia Circuit Court judge had dismissed a claim that tolls on the Dulles Greenway were being inappropriately used to fund the expansion of the Metrorail, finding that the plaintiffs lacked sufficient analysis to support their argument that the tolls constituted taxes.

### Implications

The rulings from these cases may affect the use of toll-based financing arrangements in Virginia and undermine the PPTA. Although fee-for-service projects should not be affected, tolls that are not reasonably related to the benefits that the payer receives, or that generate revenues, may be deemed a "tax" under Virginia law—thus requiring legislative approval for the project.

The rulings may also affect bundled tolled projects, where tolls that derive revenue streams from one facility but disproportionately benefit other facilities may be considered taxes rather than fee-for-service exchanges. Not all bundling is unconstitutional, but bundling for the sole purpose of generating revenue may be deemed impermissible in Virginia.

If these rulings result in private companies turning away from PPP arrangements, due to the increased costs and uncertainty, then states like Virginia will be left to seek other sources of funding (such as state financing or federal loans). PPP projects allow agencies such as VDOT to use their limited bonding capacity for other projects in the state. Thus, these rulings could also force agencies such as VDOT to allocate revenue bonds only to certain projects (due to a lack of alternate financing arrangements) and reduce the total number of projects that a state can undertake.

<sup>3</sup> 702 F.3d 1334 (Fed. Cir. 2012).

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