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Structuring Public-Private Partnerships: Implications from the "Public-Private Investment Program for Legacy Securities"

BY FANNIE CHEN*

This Note draws upon the experiences of participants in the U.S. Department of Treasury's Public-Private Investment Program ("PPIP") to provide insight on structuring public-private partnerships ("PPPs"). PPPs enable the government to leverage private sector capital and expertise with public resources to deliver social goods. Drawing upon anecdotal interviews with PPIP fund managers, Treasury officials, and legal practitioners, this Note provides an empirical analysis of the challenges that can arise in a public-private context and potential solutions in response. The experiences of PPIP participants reveal that the fear of political risk coupled with limited legal recourse are significant concerns for the private sector, but can be addressed by sufficiently attractive market-based incentives as well as extra-legal mechanisms. Moreover, PPIP demonstrates that these extra-legal mechanisms can also help reduce the financial cost of PPPs. Concurrently, building a process whereby private parties compete for participation in a PPP through an auction-like mechanism can help government actors accurately gauge the level of private sector risk-aversion ex ante and calibrate the optimal amount of financial incentive needed to attract private sector participation.

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I. INTRODUCTION

The increasing limitations on the financial and technical capacity of government actors to provide public goods and services underscore the importance of effectively utilizing public-private partnerships ("PPPs"). Although there are various models of PPPs, the basic framework entails a risk and capital-sharing contract between public and private sector partners on a project of relatively long duration.[1] PPPs are often employed for projects that require a large amount of up-front investment or private sector expertise to implement, such as public infrastructure projects or those requiring highly technical, industry-specific knowledge.[2]

PPPs enable the government to attract private investment to sectors typically deemed financially unattractive by providing a subsidy in the form of a capital transfer to the private participant and thus lowering the cost of capital for private partners.[3] In effect, the subsidy serves as a risk premium to help overcome the private sector's risk aversion to sectors typically deemed financially unattractive and the inherent unpredictability of contracting with a sovereign entity.

Yet, given that PPPs essentially transfer public funds to private parties, it is important to ensure PPPs do not transfer excessive amounts of public wealth to private participants. To avoid such a scenario entails both setting the amount of subsidy at the optimal level, i.e., at the minimum amount necessary to attract the desired level of private participation, and structuring the PPP to properly align private and public incentives.[4]

This Note draws upon the experiences of participants in the U.S. Department of Treasury's Public-Private Investment Pro-

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1. *See* ANDREAS KAPPELER & MATHIEU NEMOZ, EUROPEAN INV. BANK, PUBLIC-PRIVATE PARTNERSHIPS IN EUROPE — BEFORE AND DURING THE RECENT FINANCIAL CRISIS 3–4 (2010), *available at* http://www.eib.org/epec/resources/efr_epec_ppp_report.pdf; Eduardo Engel, Ronald Fischer & Alexander Galetovic, *The Basic Public Finance of Public-Private Partnerships* 1 (Cowles Found. for Research in Econ. Yale Univ., Cowles Found. Discussion Paper No. 1618, 2011) [hereinafter *Basic Public Finance*], *available at* http://cowles.econ.yale.edu/P/cd/d16a/d1618.pdf.

2. *See* Marian Moszoro & Pawel Gasiorowski, *Optimal Capital Structure of Public-Private Partnerships* 3 (Int'l Monetary Fund, IMF Working Paper, 2008), *available at* http://www.imf.org/external/pubs/ft/wp/2008/wp0801.pdf.

3. *Basic Public Finance*, *supra* note 1, at 6.

4. See Bebchuk, *infra* note 10, at 4.

gram[5] ("PPIP") to offer lessons learned on calibrating an optimal subsidy level, such that the government attracts the desired level of private sector participation while keeping its financial subsidy to private partners at a minimum. As one of thirteen Troubled Asset Relief Program ("TARP") initiatives, PPIP leveraged private-sector equity with government equity and debt financing to purchase qualifying mortgage-backed securities from financial institutions to restore credit-market functioning during the depths of the 2008–2009 financial crisis.[6] Although PPIP garnered significant attention when it was announced, there has been no post-hoc analysis of the program's structure, participants' experiences or implications to be drawn from the program.

The findings in this Note are based on interviews with PPIP fund managers, Treasury Department officials, and legal practitioners conducted throughout the Fall of 2011 regarding their experiences with and reflections on PPIP. Recognizing the need to overcome substantial private investor wariness towards purchasing illiquid mortgage-backed securities during the financial crisis, particularly via a TARP program, the Treasury Department offered attractive financial terms to help overcome the economic, reputational and regulatory risk of participating in PPIP. In addition to providing attractive financial incentives, the government sought to minimize the private sector's aversion to the regulatory risks inherent to contracting with a sovereign entity by signaling its commitment to program terms through extra-legal mechanisms, such as extensive communication with participants and ensuring accessibility to senior-level officials informed by private sector experience.

Anecdotal reflections from PPIP participants and the significant level of interest from a substantial number of fund managers[7] during the application process suggest that PPIP's terms

5. *See Public-Private Investment Program*, U.S. DEP'T OF THE TREASURY, http://www.treasury.gov/initiatives/financial-stability/TARP-Programs/credit-market-programs/ppip/Pages/default.aspx (last updated Dec. 18, 2012).

6. *Id.*

7. By the end of the PPIP application period, Treasury had received over 140 distinct applications from fund managers. OFFICE OF THE SPECIAL INSPECTOR GEN. FOR THE TROUBLED ASSET RELIEF PROGRAM, SELECTING FUND MANAGERS FOR THE LEGACY SECURITIES PUBLIC-PRIVATE INVESTMENT PROGRAM 1 (2010) [hereinafter SIGTARP, SELECTING FUND MANAGERS], *available at* http://www.sigtarp.gov/Audit%20Reports/Selecting%20Fund%20Managers%20for%20the%20Legacy%20Securities%20Public-Private%20Investment%20Program%2009_07_10.pdf. While this number may not repre-

were sufficiently attractive to overcome substantial risks from the private sector's perspective.[8] Moreover, as this Note will reveal, all fund participant interviewees emphasized the effectiveness of PPIP's extra-legal mechanisms at reducing their risk aversion to participating in a government-sponsored program. Two implications emerge from these findings. First, the level of enthusiasm and positive responses from interviewees suggests that one of the main challenges in structuring a PPP is accurately gauging private sector risk-aversion ex ante and calibrating the amount of financial subsidy needed to overcome the risk aversion of private partners.[9] Consequently, one useful mechanism going forward may be a competitive bidding process, such as an auction, among private partners to enable the government to discover the optimal subsidy level in structuring a PPP. An auction would eliminate the need for the government to predict the degree of risk aversion of private partners ex ante and reduce the likelihood of "oversubsidization."[10] Second, to the extent that private participants would have demanded higher financial returns, i.e., a greater government subsidy, had there been fewer extra-legal mechanisms to help alleviate their risk aversion, PPIP demonstrates that ensuring extensive engagement and building trust between public and private participants can help reduce the financial cost of PPPs.[11]

The remainder of this Note is organized as follows. Part II discusses the structure and evolution of PPIP. Part III presents the results from interviews with PPIP participants on the perceived risks by private partners, considerations in evaluating PPIP, and contractual as well as extra-legal mechanisms employed by the government to overcome investor concerns. Part IV discusses the takeaways and implications from PPIP for structuring and implementing PPPs going forward. Lastly, Part V concludes.

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sent a sufficiently conclusive level of investor interest, it does reflect a substantial amount of interest among the qualified investor base at the time. That said, given that this author was only able to interview actual PPIP participants, it may be worthwhile for future scholarship to obtain the reflections of private investors who ultimately chose not to participate in PPIP as a comparison point.

8. *See infra*, Part III.C, at 17.

9. *See infra*, Part IV, at 21.

10. *Basic Public Finance*, *supra* note 1, at 3; *See also* Lucian A. Bebchuk, *Buying Troubled Assets*, 26 YALE J. ON REG. 343, 350 (2009).

11. *See infra*, Section IV.B.ii, at 25.

II. PPIP OVERVIEW

As one of thirteen TARP initiatives, PPIP deployed private-sector equity combined with TARP equity and debt financing to purchase eligible assets[12], dubbed "legacy securities"[13] under PPIP, from financial institutions.[14] By leveraging private sector capital with government equity and debt, PPIP aimed to "restart the market for legacy securities," allowing banks and other financial institutions to free up capital and stimulate the extension of new credit."[15]

At its official unveiling on March 23, 2009, the U.S. Department of Treasury ("Treasury") announced that PPIP would use $75 billion to $100 billion of TARP funds, alongside private capital, to buy eligible assets.[16] The program was eventually scaled back when the Legacy Loans component was put on hold indefinitely,[17] with Treasury subsequently pledging up to $30 billion for the remaining Legacy Securities program.[18]

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12. "Eligible assets" are defined as non-agency residential mortgage-backed securities ("non-agency RMBS") and commercial mortgage-backed securities ("CMBS") that were: issued before January 1, 2009; rated when issued AAA or equivalent by two or more credit rating agencies; secured directly by actual mortgages, leases, or other assets, not other securities; located primarily in the U.S.; and purchased from financial institutions that are eligible for TARP participation. *See Public-Private Investment Program*, U.S. DEP'T OF THE TREASURY, http://www.treasury.gov/initiatives/financial-stability/programs/Credit%20Market%20Programs/ppip/Pages/publicprivatefund.aspx (last visited April 6, 2013).

13. Legacy securities, i.e., eligible assets, are real estate-related securities originally issued before Jan. 1, 2009 that remained on the balance sheets of financial institutions because of pricing difficulties that resulted from market disruption. OFFICE OF THE SPECIAL INSPECTOR GEN. FOR THE TROUBLED ASSET RELIEF PROGRAM, JANUARY 2012 QUARTERLY REPORT TO CONGRESS 123 [hereinafter JAN. 2012 SIGTARP REPORT], *available at* http://www.sigtarp.gov/Quarterly%20Reports/January_26_2012_Report_to_Congress.pdf.

14. *Public-Private Investment Program*, *supra* note 12.

15. *Id.*

16. *Id.*

17. Treasury originally designed PPIP as two components, with the Treasury-led component purchasing "legacy securities" and another FDIC-led component purchasing "legacy loans." However, the FDIC put the legacy loans program on hold indefinitely in June 2009, while Treasury continued to move forward with its half of PPIP. SIGTARP, SELECTING FUND MANAGERS, *supra* note 7, at 4 n.6. Thus, this report focuses on the Legacy Securities component of PPIP and uses the terms PPIP and Legacy Securities Program interchangeably. *Id.*

18. OFFICE OF THE INSPECTOR GEN. FOR THE TROUBLED ASSET RELIEF PROGRAM, JULY 2011 QUARTERLY REPORT TO CONGRESS 124 (2011) [hereinafter JULY 2011 SIGTARP REPORT], *available at* http://www.sigtarp.gov/Quarterly%20Reports/July2011_Quarterly_Report_to_Congress.pdf.

A. PPIP'S GENESIS

In September 2008, the Bush Administration initially proposed that the government purchase up to $700 billion worth of asset-backed securities from financial institutions using public funds.[19] However, this approach did not prove viable given the intensity and pace of the crisis, which demanded a faster response, and elicited strong objections that the government was ill-equipped to act as a direct purchaser.[20] The fundamental issue was that buying asset-backed securities from the secondary market was not seen as one of the government's "core competencies," as the government had neither the human nor technological resources to accurately value such assets.[21]

Thus, after the Obama Administration came into office, Secretary of the Treasury Timothy Geithner announced the development of a program to partner public and private capital to purchase distressed assets from financial institutions in March 2009.[22] By devising a public-private structure, the government could partner with private sector participants that already had the technology, manpower, and compliance systems in place to directly purchase these assets.[23] At the same time, the government believed that with the support of government capital, the private sector could be induced to purchase these then-illiquid assets at prices sufficient to attract financial institutions to sell, thus injecting capital into the financial system and helping restore the nation's frozen credit markets.[24]

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19. Bebchuk, *supra* note 10, at 344.
20. *Id.*
21. Telephone interview with Official A, Senior Official, Office of Fin. Stability, U.S. Dep't of Treasury (Dec. 16, 2011) [hereinafter Interview with OFS]. *See infra* Part III.A (discussing interview methodology and need for anonymity).
22. Bebchuk, *supra* note 10, at 344.
23. Interview with OFS, *supra* note 21.
24. DAVIS POLK & WARDWELL, LLP, FINANCIAL CRISIS MANUAL, CHAPTER 7: THE PUBLIC-PRIVATE INVESTMENT PROGRAM 182 (2009), *available at* http://www.davispolk.com/files/Publication/d1ab7627-e45d-4d35-b6f1-ef356ba686f2/Presentation/PublicationAttachment/2a31cab4-3682-420e-926f-054c72e3149d/fcm.pdf.

B. PPIP STRUCTURE

Under PPIP, private investors and Treasury co-invested in partnerships, called Public-Private Investment Funds ("PPIF"), to purchase legacy securities from eligible sellers.[25] Treasury selected nine asset management firms to establish PPIFs, one of which subsequently withdrew,[26] raise private-sector capital, and manage assets throughout the eight-year term of PPIP.[27]

For each of the eight remaining PPIF managers[28], Treasury matched up to $1.2 billion[29] of private-sector equity and provided additional non-recourse debt financing for up to 100 percent of the total combined private and TARP equity, thus funding approximately 75 percent of each PPIF.[30]

Each partner in the PPIF shared profits and losses on a pro rata basis based on their partnership interests,[31] with the loss capped for private investors by the amount of their equity in-

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25. Eligible sellers are defined as (i) financial institutions, "including, but not limited to, any bank, savings association, credit union, security broker or dealer, or insurance company, established and regulated under the laws of the United States or any State, territory, or possession of the United States, the District of Columbia, Commonwealth of Puerto Rico, Commonwealth of Northern Mariana Islands, Guam, American Samoa, or the United States Virgin Islands, and having significant operations in the United States, but excluding any central bank of, or institution owned by, a foreign government;" and (ii) any foreign financial authorities or banks holding troubled assets as a result of extending financing to financial institutions that have failed or defaulted on such financing. 12 U.S.C. § 5202(5) (2012) (codifying the Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, 122 Stat. 3765 (2008)); *Public-Private Investment Program*, *supra* note 5.

26. The Trust Company of the West Group, LLP ("TCW") withdrew as a PPIF manager due to the departure of a "key person." JULY 2011 SIGTARP REPORT, *supra* note 18 at 88.

27. SIGTARP, SELECTING FUND MANAGERS, *supra* note 7, at 17–18 (Treasury announced the pre-qualification of nine fund managers on July 8, 2009).

28. *See infra*, Table 1.

29. The original maximum Treasury capital contribution was $1.1 billion, but funds committed to TCW were reallocated to the remaining PPIFs after TCW withdrew. Thus, the total maximum Treasury capital commitment was raised to $1.2 billion as of March 22, 2010. Letter from Herbert M. Allison Jr., Assistant Sec'y for Financial Stability, U.S. Dep't of the Treasury, to PPIP Fund Managers (2010), *available at* http://www.treasury.gov/initiatives/financial-stability/programs/Credit%20Market%20Programs/ppip/s-ppip/Documents/AB%20UST%20Reallocation%20-%20Letter%20Redacted.pdf.

30. JAN. 2012 SIGTARP REPORT, *supra* note 13, at 123.

31. In addition, Treasury received warrants of 2.5 percent in each PPIF, as mandated by the Emergency Economic Stabilization Act of 2008. *See* U.S. DEP'T OF TREASURY & PPIF FUND MANAGERS, AMENDED AND RESTATED LIMITED PARTNERSHIP AGREEMENT [hereinafter PPIF LPA], *available at* http://www.treasury.gov/initiatives/financial-stability/tarp-programs/credit-market-programs/ppip/Documents/Invesco%20Executed%20LPA%20(redacted).pdf.

vestment.[32] Thus, private investors collectively stood to receive half of overall profits, but were limited in their loss to the amount of their equity investment.[33]

i. *Purchasing Power*

At the end of the fundraising period on June 18, 2010,[34] the eight remaining PPIFs had collectively raised approximately $7.4 billion of private-sector equity, which was matched by Treasury, totaling $14.7 billion of total equity commitments.[35] Treasury then provided an additional $14.7 billion of debt financing, amounting to a total PPIF purchasing power of $29.4 billion.[36]

Each PPIF manager had a three-year investment period from its initial closing to draw upon the TARP funds obligated for the PPIF.[37] The last of the three-year investment periods expired in December 2012.[38] At the end of the PPIF investment period, fund managers have five years ending in 2017 to manage and liquidate the fund's investment portfolio and return proceeds to Treasury and investors.[39] Four PPIF managers have wound down or dissolved their funds as of December 31, 2012 and fully repaid Treasury's debt and equity investments; the other four are in various stages of portfolio management and repaying Treasury.[40] In total, the eight PPIF managers have drawn down approximately

32. JAN. 2012 SIGTARP REPORT, *supra* note 13, at 123.

33. *Id.*

34. The first PPIF initial closing took place on September 30, 2009, and the final fund's initial closing was completed on December 18, 2009. Following each PPIF's initial close, each fund had the opportunity to raise additional private sector capital commitments at up to two subsequent closings over the next six months prior. *Public-Private Investment Program*, *supra* note 12.

35. JAN. 2012 SIGTARP REPORT, *supra* note 13, at 124.

36. OFFICE OF THE INSPECTOR GEN. FOR THE TROUBLED ASSET RELIEF PROGRAM, JANUARY 2013 QUARTERLY REPORT TO CONGRESS 128 (2013) [hereinafter JAN. 2013 SIGTARP REPORT], *available at* http://www.sigtarp.gov/Quarterly%20Reports/January_30_2013_Report_to_Congress.pdf. *See infra* Table 2 (demonstrating breakdown of total amount of capital drawn down, as of December 31, 2012).

37. PPIF LPA, *supra* note 31, at Art.1, 3.2(a)(ii).

38. JAN. 2013 SIGTARP REPORT, *supra* note 36, at 128–29.

39. *Id.* at 129.

40. Invesco, AllianceBernstein, RLJ Western, and BlackRock announced it had liquidated its PPIF portfolio on Apr. 3, 2012, Oct. 9, 2012, Nov. 20, 2012 and Dec. 5, 2012, respectively. *Id.* at 132.

$24.4 billion to purchase legacy securities during the investment period, amounting to 83 percent of the total purchasing power.[41]

Table 1

PPIP Purchasing Power and Capital Drawn Down during Investment Period as of December 31, 2012[42] ($ billions)

Manager	Private-Sector Equity Capital	Treasury Equity	Treasury Debt	Total Purchasing Power	Total Drawn Down
AG GECC PPIF Master Fund, L.P.	$1.2	$1.2	$2.5	$5.0	$4.5
AllianceBernstein Legacy Securities Master Fund, L.P.	1.2	1.2	2.3	4.6	4.3
BlackRock PPIF, L.P.	0.7	0.7	1.4	2.8	2.1
Invesco Legacy Securities Master Fund, L.P.	0.9	0.9	1.7	3.4	2.3
Marathon Legacy Securities Public-Private Investment Partnership, L.P.	0.5	0.5	0.9	1.9	1.9
Oaktree PPIP Fund, L.P.	1.2	1.2	2.3	4.6	2.2
RLJ Western Asset Public/Private Master Fund, L.P.	0.6	0.6	1.2	2.5	2.5
Wellington Management Legacy Securities PPIF Master Fund, L.P.	1.1	1.1	2.3	4.6	4.6
Current Totals	$7.4	$7.4	$14.7	$29.4	$24.4

41. *See* Table 1, *infra*, for breakdown of total amount of capital drawn down, as of December 31, 2012. Obligated funds by Treasury and private investors are not given immediately to PPIF managers. Instead, PPIF managers send a notice to Treasury and the private investors requesting portions of obligated contributions in order to purchase specific investments or to pay certain expenses and debts of the partnerships. When the funds are delivered, the PPIF is said to have "drawn down" on the obligation. *See* PPIF LPA, *supra* note 31, at 17–18; *see also* JAN. 2013 SIGTARP REPORT, *supra* note 36, at 123, 130.

42. *Id.* at 130.

ii. *Investment Guidelines*

Although fund managers maintain full control over asset selection, pricing, liquidation, trading and disposition, the PPIF Limited Partnership Agreement stipulates that the investment objective for each PPIF is "to generate attractive returns . . . through long-term opportunistic investments in Eligible Assets."[43] Neither Treasury nor the private investors have voluntary withdrawal rights over the eight-year term of the PPIF,[44] subject to specific conditions that would allow withdrawal or result in dissolution of the PPIF.[45] Moreover, Treasury required PPIFs to be long-only investment funds, restricting PPIF managers from entering into any derivatives contract other than interest rate hedges.[46]

C. PPIF PERFORMANCE

As of December 31, 2012, the four PPIFs still managing investments have reported net internal rates of return since inception ranging from 18.22 percent to 28.14 percent.[47] The last reported net internal rates of return since inception for the four funds that have been liquidated or dissolved range from 15.52 percent to 18.24 percent.[48] In comparison, total S&P 500 returns for the past three years as of February 28, 2013 averaged 13.5 percent.[49] Also, as of December 31, 2012, the PPIFs have collectively paid $6.3 billion to Treasury in equity distributions, which

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43. PPIF LPA, *supra* note 31, at 24.
44. *Id.* at 42–43.
45. *See id.* at 32 (stipulating that private investors may only withdraw from a PPIF if, inter alia, retaining an interest would cause a "material adverse effect on [the PPIF]," or create a "substantial likelihood that [the] Private Investor . . . would be violating a law . . . ."). *See also id.* at 43 (stipulating events, such as changes in a "law, regulation, rule, or governmental order . . . that would materially adversely impact" a majority of the investors as a result of their participation in the PPIF, as grounds for dissolution).
46. *Id.* at 25.
47. JAN. 2013 SIGTARP REPORT, *supra* note 36, at 133. *See infra* Table 2 (fund performance data as of Dec. 31, 2012).
48. OFFICE OF THE INSPECTOR GEN. FOR THE TROUBLED ASSET RELIEF PROGRAM, JULY 2012 QUARTERLY REPORT TO CONGRESS 139 (2012), *available at* http://www.sigtarp.gov/Quarterly%20Reports/July_25_2012_Report_to_Congress.pdf.
49. *S&P 500*, S&P 500, STANDARD AND POOR'S, http://www.standardandpoors.com/indices/sp-500/en/us/?indexId=spusa-500-usduf--p-us-l-- (last updated Feb. 28, 2013).

include gross income distributions, capital gains, and return of capital.[50]

Table 2

PPIF Performance Data and Payments to Treasury, as of December 31, 2012[51]		
Manager	Net Internal Rate of Return Since Inception (%)	Equity Distribution Payments to Treasury ($ millions)
Funds still managing investments		
AG GECC PPIF Master Fund, L.P.	23.73%	$982
Marathon Legacy Securities Public-Private Investment Partnership, L.P.	23.03	223
Oaktree PPIP Fund, L.P.	28.14	337
Wellington Management Legacy Securities PPIF Master Fund, L.P.	18.22	372
Funds winding down/dissolved[52]		
AllianceBernstein Legacy Securities Master Fund, L.P.	15.52	1,545
BlackRock PPIF,	15.88	921

50. JAN. 2013 SIGTARP REPORT, *supra* note 36, at 131. *See* Table 2 for equity distributions to Treasury, as of Dec. 31, 2012.
51. JAN. 2013 SIGTARP REPORT, *supra* note 36, at 131, 133.
52. Net internal rates of return since inception for funds winding down or dissolved are as of Jun. 30, 2012, the last reported date. *Id.* at 139.

L.P.		
Invesco Legacy Securities Master Fund, L.P.	18.24	720
RLJ Western Asset Public/Private Master Fund, L.P.	17.45	1,041
UST/TCW Senior Mortgage Securities Fund, L.P.	N/A	176
Totals for All Funds	N/A	$6,317

Although PPIP garnered significant attention when it was announced, little exists in the way of a post-hoc analysis of the program's structure, participants' experiences or lessons learned from the program. The next section will describe findings based on anecdotal interviews with fund managers, Treasury officials and legal practitioners. Part IV will then discuss the potential implications of these results for implementing public-private partnerships going forward.

III. INTERVIEWS WITH PPIP PARTICIPANTS

This section reveals anecdotal findings from a series of interviews with PPIP participants, highlighting the overarching concerns of both private and public partners and the mechanisms used to address them. Part A will first discuss the methodology of the study. The remaining three subsections will discuss the results from interviews with fund managers and Treasury officials.

In sum, conversations with PPIP fund managers reveal that private investors were primarily concerned about the regulatory uncertainty surrounding PPIP and possible reputational harm associated with being a TARP recipient. It was thus critical for PPIP officials to offer sufficiently attractive financial incentives to attract private capital and provide a credible commitment device to increase confidence in contracting with a sovereign entity. At the same time, the government faced the challenge of preventing over-subsidization in its attempt to attract private invest-

ment and providing only the minimum amount of government subsidy needed to attract the desired level of participation.

A. Methodology

Interviewees included senior-level management from three PPIP fund managers, all of whom requested to remain anonymous. This Note will refer to them as "Fund X,"[53] "Fund Y,"[54] and "Fund Z"[55] throughout the Note. Broadly, the funds are all global asset management firms with between approximately $20 to $480 billion worth of assets under management.

Interviewees answered questions regarding the considerations their respective funds weighed when evaluating PPIP participation, which aspects of PPIP worked well or were challenging, whether they would participate in a PPIP-like program again if given the opportunity, how effective PPIP was in their opinion, and what, if any, broader lessons for public-private partnerships PPIP offered. The interviews were conducted between October and December 2011.

The author also conducted interviews with one former[56] and one current senior-level official[57] from the Treasury's Office of Financial Stability ("OFS") responsible for the design and implementation of PPIP. Questions for the OFS officials covered Treasury's objectives for PPIP, how the government balanced private and public interests, what challenges and successes they encountered during PPIP's design and implementation, how effective PPIP was in their opinion, and what, if any, broader lessons for public-private partnerships PPIP offered.

This Note also draws on an interview with a partner[58] from a leading law firm ("Firm K") who analyzed PPIP during its early

53. Comments attributed to Fund X are based on Telephone Interview with Chief Admin. Officer, Fund X (Oct. 21, 2011) [hereinafter Interview with Fund X].

54. Comments attributed to Fund Y are based on Interview with Exec. Vice President, Fund Y, in N.Y.C., N.Y. (Nov. 2, 2011) and Interview with Vice President of Fixed Income/Structured Assets Div., Fund Y, in N.Y.C., N.Y. (Nov. 2, 2011) [hereinafter Interviews with Fund Y].

55. Comments attributed to Fund Z are based on Telephone Interview with Head of U.S. Mktg. and Consultants, Fund Z (Dec. 2, 2011) [hereinafter Interview with Fund Z].

56. *See* Interview with OFS Official B, *infra* note 86.

57. *See* Interview with OFS Official A, *supra* note 21.

58. Comments attributed to Firm K are based on Telephone Interview with Partner, Investment Mgmt./Private Funds Group, Firm K (Oct. 14, 2011) [hereinafter Interview with Firm K].

phases. This conversation focused on initial investor concerns at PPIP's announcement, which factors attracted or deterred private participation, and what, if any, broader lessons for public-private partnerships PPIP offered.

The following sections discuss the results from interviews with the participants listed above, specifically the major areas of concern private participants had regarding PPIP and the mechanisms Treasury officials devised to address them.

B. PRIVATE PARTICIPANT CONCERNS AND RISK AVERSION

One overarching concern shared by fund managers considering PPIP was the potential for ex-post regulatory changes and a possibly intrusive level of government control. At the time that PPIP was announced, a deep distrust of government was pervasive within the private sector, given the regulatory unpredictability experienced with the "auto bailout" program and TARP.[59]

Indeed, Fund Y reported that this distrust was the most salient challenge it encountered in raising private capital.[60] Fund X also remarked that one of its main initial concerns was that the government could unilaterally change the terms and regulatory provisions at any point, possibly imposing new, potentially disadvantageous requirements and restrictions on the PPIFs.[61] Similarly, Fund Z reflected that its biggest concern was also the possibility of unilateral changes to contractual terms by the government in the future, a concern that was very much shared by its investors.[62] In fact, Fund Z attributed its inability to raise the maximum Treasury allocation of $1.2 billion primarily to investor concerns over political risk and the possibility of post-hoc rule changes to PPIP.[63]

Additionally, fund managers were concerned about possible restrictions on executive compensation — even after Treasury released a clarifying statement[64] stipulating that PPIF managers

59. Interview with Fund Y, *supra* note 54.
60. *Id.*
61. Interview with Fund X, *supra* note 53.
62. Interview with Fund Z, *supra* note 55.
63. *Id.*
64. *See Legacy Securities Public-Private Investment Program (Legacy Securities PPIP), Additional Frequently Asked Questions*, U.S. DEP'T OF TREASURY 7 (July 8, 2009),

would not be subject to executive compensation regulations under TARP, funds remained skeptical given the government's monopoly on rule-making and legislative power.[65] Moreover, this skepticism was heightened due to the public outrage over bonuses paid out by the American International Group (AIG) as a TARP recipient in the spring of 2009 and retroactive punitive legislative actions in response.[66]

The anxiety over regulatory uncertainty was heightened by the politically-charged environment surrounding TARP at the time of PPIP's announcement.[67] The public debate over TARP lead to investor fears of reputational harm caused by participating in a TARP program.[68] The resulting tension between public and private sector objectives was particularly acute in PPIP's case as private fund managers would risk public, taxpayer dollars to generate private gain for themselves and their investors. Indeed, the attractive government financing led some commentators to deride PPIP as essentially an indirect, disguised taxpayer subsidy for purchasing toxic assets from irresponsible banks.[69] Given the non-recourse nature of the government loans, critics attacked PPIP as another giveaway to the very institutions that caused the financial crisis in the first place, as private investors would share in all of the upside, but were limited in the loss they would suffer.[70] Commentators also feared that this limit on losses would induce fund managers to make riskier bets or not be as aggressive in seeking out the best value for eligible assets.[71]

Thus, many asset management firms were concerned that if PPIP generated significant financial returns, there would be a

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http://www.treasury.gov/initiatives/financial-stability/programs/Credit%20Market%20 Programs/ppip/s-ppip/Documents/legacy_securities_faqs.pdf.

65. Interview with Fund X, *supra* note 53; Interview with Fund Z, *supra* note 55.

66. Interview with Fund X, *supra* note 53.

67. *See* Peter J. Wallison, *New Plan, Old Fears*, THE AMERICAN (Mar. 24, 2009), http://www.american.com/archive/2009/march-2009/new-plan-old-fears (discussing the deterrent effects of public backlash and Congress's clawback actions on private-sector participants).

68. Interview with Firm K, *supra* note 58.

69. Paul Krugman, Op-Ed., *Financial Policy Despair*, N.Y. TIMES, Mar. 23, 2009, at A21.

70. *Id.*; Joseph E. Stiglitz, Op-Ed., *Obama's Ersatz Capitalism*, N.Y. TIMES, Apr. 1, 2009, at A31.

71. Jeffrey Sachs, Op-Ed., *Obama's Bank Plan Could Rob the Taxpayer*, FIN. TIMES (Mar. 25, 2009), http://www.ft.com/intl/cms/s/0/b3e99880-1991-11de-9d34-0000779fd2ac.html#axzz2P2lbNkcF.

public backlash over the perception that they were using taxpayer funds to generate substantial profit for themselves and their investors,[72] followed by retroactive rule changes and punitive Congressional actions.[73] Consequently, many institutional investors who were initially interested in the potential gains from PPIP ultimately decided not to "associate with TARP"[74] and risk being subject to unpredictable future regulation as beneficiaries of TARP subsidies.[75]

C. ADDRESSING PRIVATE SECTOR RISK-AVERSION THROUGH FINANCIAL MECHANISMS

As the success of PPIP hinged on attracting sufficient private investor participation, Treasury understood that it was critical for them to offer sufficiently attractive terms to overcome investors' hesitance to co-invest with the government and the perceived stigma of participating in a TARP program.[76] Recognizing these hurdles, Treasury provided substantial leverage by matching the amount of private-sector equity up to $1.2 billion and providing additional non-recourse government debt financing in the amount of the total combined equity.[77]

Treasury received a high level of interest during the fund manager application period,[78] suggesting that the financial incentives were attractive enough to override aversion towards working with the government within a significant portion of the investment community. While not all chosen fund managers were able to raise up to the limit of Treasury's maximum capital contribution, half of the funds did meet, or came close to meeting, the $1.2 billion cap (see Table 1 above).[79] In fact, Fund X remarked that it felt that PPIP was too small and it would have hoped for a higher capital contribution limit from Treasury.[80] Moreover, all

72. *Id.*
73. *Id.*
74. Interview with OFS, *supra* note 21.
75. Interview with Firm K, *supra* note 58.
76. Interview with OFS, *supra* note 21.
77. JAN. 2013 SIGTARP REPORT, *supra* note 36, at 127.
78. By the end of the PPIP application period, Treasury had received over 140 distinct applications from fund managers. SIGTARP, SELECTING FUND MANAGERS, *supra* note 7, at 1.
79. JULY 2011 SIGTARP REPORT, *supra* note 18, at 125. *See also supra* Table 2.
80. Interview with Fund X, *supra* note 53.

interviewed fund managers stated without hesitance that they would participate in PPIP again if a similar program were offered, and that they could most likely raise even more capital going forward given the strong returns thus far.[81]

Indeed, one overarching theme throughout interviews was that fund managers believed the economic upsides outweighed the risks they were taking in participating in a government-run program.[82] Specifically, fund managers appreciated that they remained free to set the management and performance fees on the pools of private-sector equity,[83] although the Treasury equity came with more demanding terms, such as smaller performance and management fees and atypical expense provisions.[84] Fund managers maintained that the availability of "cheap" government leverage in the form of non-recourse loans ultimately outweighed any downsides.[85]

Treasury's success at setting attractive financial terms was largely due to its recognition that public officials had to be sufficiently informed by private sector experience and expertise to understand what economic incentives would be attractive.[86] According to one Treasury official involved with designing PPIP, it was essential to "put ourselves in the shoes of potential private sector participants" to understand what would attract investors.[87] Yet, one of the difficulties with PPPs is that they are often designed and implemented by career government officials, who may have been out of the private sector for extended periods or may never have had private sector experience.[88]

Recognizing this, Treasury hired two individuals from the private sector to form the core of the PPIP team along with a small team of career Treasury officials.[89] This team of officials was particularly cognizant of the need to provide financial terms that were at least slightly better than those then-currently available

81. *Id.*; Interview with Fund Y, *supra* note 54; Interview with Fund Z, *supra* note 55.
82. Interview with Fund Z, *supra* note 55.
83. Interview with Fund X, *supra* note 53; Interview with Fund Z, *supra* note 55.
84. PPIF LPA, *supra* note 31, at Art. 6.
85. Interview with Fund X, *supra* note 53; Interview with Fund Y, *supra* note 54; Interview with Fund Z, *supra* note 55.
86. Interview with OFS, *supra* note 21; Interview with Official B, Former Senior Official, Office of Fin. Stability, U.S. Dep't of Treasury (Nov. 2, 2011).
87. Interview with OFS, *supra* note 21.
88. *Id.*
89. *Id.*

in the market in order to outweigh the "stigma" associated with TARP and government-sponsored programs generally.[90] Having the expertise of officials who had recently been in the private sector helped inform internal deliberations on what these terms should be and was critical in helping Treasury develop financials that would be sufficiently attractive to private investors.[91]

D. ADDRESSING PRIVATE SECTOR RISK AVERSION THROUGH EXTRA-LEGAL MECHANISMS

Also aware that wariness of regulatory changes could be a strong deterrent to private investors even with attractive financials, Treasury sought to alleviate these concerns through extra-legal mechanisms by engaging in sustained dialogue with PPIF managers and demonstrating voluntary constraint in the level of involvement in management decisions. Even prior to PPIP's formal announcement, Treasury consulted private investment firms on the market feasibility of different proposed structures, including the design of the program and the amount of capital that could realistically be raised.[92] Throughout discussions and negotiations with fund managers, Treasury officials reiterated their intention to adhere to the "rules of the game" and their view that Treasury's role was that of a limited (albeit large) partner, not that of a "rogue state-owned enterprise."[93]

Thus, while Treasury sought to ensure adequate oversight to protect the public's interests, it emphasized throughout the process their intention to minimize involvement in management decisions to allay private concerns about co-investing with a government partner.[94] Fund Y remarked that Treasury was "very smart in the way they managed PPIP," noting that at one point during the early stages of PPIP, it had formed a PPIF advisory committee with their eight largest investors, to which Treasury was invited as well.[95] Yet, Treasury ultimately declined to participate because they did not want to exert, or give the perception of

90. *Id.*
91. *Id.*
92. SIGTARP, SELECTING FUND MANAGERS, *supra* note 7, at 4; Interview with OFS, *supra* note 21.
93. Interview with OFS, *supra* note 21.
94. *Id.*
95. Interview with Fund Y, *supra* note 54.

exerting, an undue influence on the management of the PPIF.[96] This self-awareness and voluntary restraint by Treasury helped instill confidence in the government's execution and management of PPIP.[97]

Additionally, Treasury officials engaged in regular communication with fund managers in drafting the final term sheet. Inevitably, there were terms or conditions Treasury dictated which were non-negotiable given their primary role as a representative of the public's interests. However, although Treasury did not take every suggestion that fund managers put forth, they were receptive to the funds' feedback and did revise certain provisions when there was sufficient consensus among fund participants.[98]

This accessibility to senior officials and continuous dialogue throughout the PPIP process reduced private participants' fears of regulatory unpredictability. Fund Z remarked on how helpful it was to overcoming their initial hesitations to be part of the structuring process with Treasury, noting that, "Treasury was good at listening and soliciting input from the fund managers . . . even though [Treasury] didn't implement every suggestion, they would give their reason and thought process for why they rejected a recommendation."[99] Fund Y also reflected that much of their initial concerns over partnering with a sovereign entity was overcome by the continual access they had to officials, and that Treasury did a "very good job in working with the fund managers on developing the final terms and conditions."[100] These continuous interactions and communications helped instill a "solid" level of confidence and trust in the government, and helped reassure fund managers that Treasury understood their concerns and would not arbitrarily change the terms without consulting the funds beforehand.

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96. *Id.*

97. *Id.*

98. Interview with OFS, *supra* note 21.

99. Interview with Fund Z, supra note 53.

100. Interview with Fund Y, *supra* note 54. This is not to say that there was agreement on every term. Two separate Fund managers mentioned that Treasury could have a done a better job of involving funds in the choice of Bank of New York Mellon as the administrator. Funds X and Y both remarked on the feeling that they had no choice over PPIP's administrator, and frustration over BNY's inefficiency and lack of appropriate human or technological resources. Interview with Fund X, *supra* note 53; Interview with Fund Y, *supra* note 54.

Moreover, the private sector experience of PPIP officials was not only helpful when designing the program, but also significantly helpful with increasing trust between fund managers and the government. Participants were reassured by the private sector experience and understanding officials possessed, noting that Treasury's "market savvy" team and private sector experiences helped alleviate concerns over partnering with the government.[101] Fund X remarked that having government officials who spoke the "same language" as them and understood the fund's concerns was particularly helpful in overcoming the initial hesitance in working with government.[102]

Funds also noted how this market savvy helped Treasury run an efficient and professional due diligence process, again strengthening trust between the fund managers and officials.[103] Fund X remarked that they were "very impressed" by the process and the "top-notch" manner in which the government ran it, which restored their confidence in working with the government.[104] Similarly, Fund Y commented that it was a "delight" working with Treasury, given their professionalism and expertise.[105]

Lastly, while firms were concerned about the political risk of public backlash, fund managers also saw PPIP as a prestigious opportunity to increase the profile and visibility of their firms. Fund X remarked that although the financial considerations comprised the majority of the decision to participate, its decision was also influenced by the fact that it felt a "civic duty" to participate and help restore the nation's financial system.[106] Fund managers recognized that if PPIP was successful, it could generate positive publicity and exposure for their firms, potentially producing a "halo effect" should they be recognized as a top money manager for the government, and by extension, the public.[107] Every fund manager interviewed noted that being chosen as a PPIP fund manager was "prestigious," given the benefits that

101. Interview with Fund Y, *supra* note 54.
102. Interview with Fund X, *supra* note 53.
103. *Id.*; Interview with Fund Y, *supra* note 54.
104. Interview with Fund X, *supra* note 53.
105. Interview with Fund Y, *supra* note 54.
106. Interview with Fund X, *supra* note 53.
107. Interview with Fund X, *supra* note 53; Interview with Fund Z, *supra* note 55.

PPIP could bring to the financial system, and the status as an organization that can be entrusted with taxpayer money.[108]

IV. IMPLICATIONS FROM PPIP FOR STRUCTURING PUBLIC-PRIVATE PARTNERSHIPS

PPIP leveraged private and public resources to purchase legacy securities in an effort to address a key obstacle to restoring market functioning during the recent financial crisis. As the fiscal challenges confronting the U.S. and many other economies limit the amount of government resources, the role of PPPs will become increasingly important to the delivery of social goods and services. The experiences of PPIP participants offer helpful insights for effectively structuring PPPs and leveraging private capital going forward. The following section draws upon the above interview findings to highlight key challenges facing the government when trying to partner private and public resources, and possible responses to each. Based on conversations with PPIP participants and Treasury officials, one main challenge in structuring PPPs is providing a sufficient amount of subsidy to attract the desired level of private participation while only doing so to the minimum extent necessary to avoid excessive transfers of public funds to private participants.

PPIP suggests that private participants' financial and political risk aversion can be successfully overcome with a sufficiently attractive set of financials. Moreover, the enthusiasm with which PPIP applicants and participants responded to the program, despite somewhat onerous compliance and disclosure terms, further suggests that a competitive bidding mechanism may have been more effective at accurately calibrating the amount of subsidy needed to overcome the private sector's risk aversion. Finally, in addition to financial incentives, the use of extra-legal mechanisms to signal the government's commitment and increase trust between public and private participants can also help reduce private participants' risk aversion, thus lowering the cost of PPPs.

The following section is divided as follows: Part A summarizes the main areas and sources of private sector risk aversion to PPPs. Part B explores the implications that emerge from the

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108. Interview with Fund Y, *supra* note 54.

mechanisms Treasury officials devised to overcome private sector risk aversion. Finally, Part C discusses potential takeaways from PPIP for calibrating optimal subsidy levels for PPPs going forward.

A. POLITICAL RISK CONCERNS OF PRIVATE PARTNERS

Private partners in a PPP face both regulatory and perception-related political risk.

Regulatory uncertainty arises for private actors entering into an agreement with a sovereign entity given the government's monopoly on rule-making and legislative power.[109] Due to the legal doctrine of sovereign immunity, the government is generally immune from suit without its consent, such that neither Congress nor the executive branch is liable for damages for breaches of contract.[110] Consequently, private parties face continual uncertainty when contracting with the government, since Congress may breach an agreement without being subject to damages.[111]

Thus, one way to signal the credibility of the government's commitment may be to waive sovereign immunity and stipulate the ability to sue the government party in a contractual agreement. A government actor can waive sovereign immunity through explicit waivers granted by the legislature.[112] However, there is no guarantee that future sessions of Congress will not revoke the waiver,[113] a risk heightened by the relatively short election cycles and sensitivity to changing political winds of the U.S. political system.

Additionally, while the Tucker Act[114] and the Administrative Procedure Act[115] both provide waivers of sovereign immunity under certain circumstances, these statutes may do little to attract private investors ex ante given the limited legal recourse each

109. Harold J. Krent, *Reconceptualizing Sovereign Immunity*, 45 VAND. L. REV. 1529, 1531 (1992).

110. *Id.* at 1529.

111. *Id.* at 1560.

112. C. Stanley Dees, *The Future of the Contract Disputes Act: Is it Time to Roll Back Sovereign Immunity?*, 28 PUB. CONT. L.J. 545, 549 (1999).

113. Krent, *supra* note 109, at 1561.

114. *See* 28 U.S.C. § 1491(a)(1) (2006) (codifying, in part, the Tucker Act, 24 Stat. 505 (1887)).

115. *See* 5 U.S.C. § 702 (2006) (codifying, in part, the Administrative Procedure Act, Pub. L. 79–404, 60 Stat. 237 (1946)).

offers — courts have emphasized that waivers of immunity will be strictly construed[116] and consistently interpreted the Tucker Act as waiving sovereign immunity only for claims seeking monetary damages.[117] Thus, sovereign immunity may still deter private parties from contracting with government entities even with the availability of waivers, given the uncertainty of the scope of potential waivers and the limited nature of damages private parties can seek.

Lastly, while there is precedent allowing private parties to sue a federal agency for failing to honor a loan guaranty commitment,[118] the uncertainty over the cost and outcome of litigation against a sovereign party may still deter significant private capital ex ante. At the very least, concern over regulatory uncertainty by private parties, combined with the limited legal recourse against sovereign parties, will raise the cost of capital for the government as private investors internalize the increased level of risk.

In addition to regulatory risk, all PPIP participants from both the public and private sectors highlighted the stigma attached to government-sponsored programs, particularly those considered to be TARP programs.[119] As discussed above, many institutional investors were initially drawn to the attractive financials under PPIP, but ultimately declined to participate due to the stigma of being associated with "TARP bailouts" and potential public backlash should they generate profitable returns through PPIP.

B. OVERCOMING PRIVATE RISK-AVERSION THROUGH FINANCIAL INCENTIVES AND EXTRA-LEGAL MECHANISMS

i. *Financial Incentives*

A consistent theme emerging from interviews with PPIF managers was that PPIP offered sufficiently attractive financial in-

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116. Dees, *supra* note 112, at 549.

117. *Id.*

118. *See* Wells-Fargo Bank v. United States, 88 F.3d 1012, (Fed. Cir. 1996) (holding that the Farmer Home Administration breached its agreement with Wells-Fargo by failing to honor its commitment to guaranty a construction loan that the bank had extended pursuant to the federal ethanol loan guaranty program, awarding the bank damages from writing off part of borrower's indebtedness).

119. *See supra* Section III.

centives to overcome private sector concerns about partnering with the government and the attendant regulatory and political uncertainty. All PPIF managers testified that the overwhelmingly attractive financials of PPIP ultimately prevailed over concerns they held about working with Treasury.[120] Even with their reservations over the more extensive disclosure and compliance requirements that accompany a public program, Fund Y commented that they would participate in another PPIP-like program if similarly attractive financing terms were available.[121] Funds Z and X also commented that although there were more onerous requirements than those attached to a typical private fund, the attractive financing outweighed all of these downsides, given the fact that ultimately, these conditions still allowed sufficient flexibility for the funds to pursue their desired investment strategies.[122]

PPIP's experience demonstrates that providing sufficient financial incentives is critical to attracting sufficient private sector participation in a PPP. Part of PPIP's success in doing so is attributable to the private sector experience of the Treasury officials structuring the program, as it provided invaluable insight into how private partners would respond to varying levels of incentives. The importance of understanding the motivations and incentives of private partners when implementing a PPP highlights one of the benefits of the "revolving door" phenomenon, or the movement of personnel between private and public sectors.[123] While typically viewed in an unfavorable light due to the potential for regulatory capture,[124] PPIP offers an example of when the private sector background of key officials positively benefitted the public by helping the government effectively leverage private sector resources to provide a social good. Although such a benefit does not outweigh the negative consequences of regulatory cap-

120. Interview with Fund X, *supra* note 53; Interview with Fund Y, *supra* note 54; Interview with Fund Z, *supra* note 55.

121. Interview with Fund Y, *supra* note 54.

122. Interview with Fund X, *supra* note 53; Interview with Fund Z, *supra* note 55.

123. *See Revolving Door*, OPENSECRETS.ORG, http://www.opensecrets.org/revolving/index.php (last visited Mar. 5, 2013).

124. *See e.g.*, PROJECT ON GOV'T OVERSIGHT, DANGEROUS LIAISONS: REVOLVING DOOR AT SEC CREATES RISK OF REGULATORY CAPTURE 2–3 (2013), *available at* http://www.pogo.org/our-work/reports/2013/dangerous-liaisons-revolving-door-at-sec.html.

ture, it does highlight a positive justification for government officials moving between public and private sectors.

ii. *Extra-legal Mechanisms*

In addition to providing market-based incentives, providing a credible commitment device to private investors to reduce concerns of regulatory unpredictability can help reduce the financial costs of public-private programs. Given the limited and uncertain legal recourse for private parties against sovereign entities, reinforcing its intent to abide by the terms of a public-private program through extra-legal mechanisms can reduce the perceived risk to private participants of contracting with a sovereign entity and thus the amount of financial subsidy the government must offer to compensate for that risk.[125]

One way to credibly convey the government's commitment is ensuring consistent engagement between market-savvy government officials and private sector participants. As PPIP demonstrated, this constant communication between fund managers and public officials was one of the main mechanisms through which the government built confidence among fund managers.[126] At the same time, the restraint that Treasury voluntarily placed on their own involvement and its willingness to play the same role as other limited partners when possible decreased concerns about possible government overreach.[127]

Moreover, the importance of drawing upon private sector experience again proved beneficial, as all managers commented that what particularly instilled confidence in them was the deep market knowledge of the PPIP officials and the "common language" they shared.[128] Here, not only was prior private sector experience helpful in structuring the program to be attractive to private partners, it also helped lower the financial cost of PPIP by reducing private sector risk aversion to participating in a government-sponsored initiative and thus the amount of financial subsidy needed to overcome such aversion. Consequently, not only can the "revolving door" be helpful in structuring PPPs, it

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125. *See supra* Section III.D.
126. *Id.*
127. *Id.*
128. Interview with Fund X, *supra* note 53.

can also help lower the cost of providing social goods and services for the public by enhancing trust and cooperation between public and private partners.

The level of officials to whom fund managers had access was also important to allaying private sector concerns about regulatory authority and political risk.[129] Accessibility to senior-level officials that could speak for the agency and held the trust and confidence of their superiors was particularly reassuring to fund managers. One implication of this is the importance of ensuring centralized government authority over a PPP. Preventing overly-diffuse control mitigates the possibility of jurisdictional conflicts and helps participants identify clear lines of authority and key personnel to whom they can reach out with any concerns.

High turnover rates, particularly among new employees within the public sector present a challenge to this model.[130] Attrition rates vary widely among federal agencies, but data indicate that within some agencies, such as the Departments of Treasury, Commerce and Homeland Security, more than one-third of new employees leave within two years.[131] Consequently, one option the government could explore is employee retention contracts for key personnel in public-private programs to ensure continuity and stability. Obviously, this may raise costs for the government or lead to a decreased pool of talent for public sector positions, but these concerns should be balanced against the benefits of consistency in the execution of certain programs.

Another challenge to providing access to senior officials is scalability. Overall, the limited scope of PPIP made it possible for Treasury officials to personally review all applications and discuss issues of concern with participants. However, as programs scale-up, resource limitations on the implementing agency will make it more difficult to ensure the same level of personal interaction, thus restricting the government's ability to enhance its commitment credibility through engagement and access.

One possible solution to this limitation on personnel resources would be to ensure an authoritative, centralized and updated

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129. Interview with Fund X, *supra* note 53; Interview with Fund Y, *supra* note 54.

130. P'SHIP FOR PUB. SERV. & BOOZ ALLEN HAMILTON, BENEATH THE SURFACE: UNDERSTANDING ATTRITION AT YOUR AGENCY AND WHY IT MATTERS 3 (2010), *available at* http://ourpublicservice.org/OPS/publications/viewcontentdetails.php?id=151.

131. *Id.*

website with information and responses to concerns as they arise. For example, during the application phase, Treasury officials released updated FAQs in response to applicants' concerns and questions so that the information could be equally and broadly accessible to all applicants.[132] Similar information nexuses and resource centers for public-private partnerships in the future would help provide clarity and reassurance to private sector participants.

Lastly, although the attractive financials helped overcome the concern over participating in a stigmatized government program for many funds, some institutional investors declined to participate due to the headline and political risks of TARP.[133] One implication to draw from this is the importance of preventing future public-private programs from being tainted by association with publicly unpopular programs that would either deter private capital completely or raise the cost of capital for these programs. This could be achieved through, inter alia, providing clear, independent Congressional authorization for each public-private initiative, thus preventing damaging associations.

C. Implications for Calibrating Optimal Subsidy Levels

Attracting sufficient private sector buy-in was critical to the success of PPIP and more generally, all PPPs. The substantial level of interest from the investment community during PPIP's application process, coupled with actual participants' strong endorsement of the financials,[134] highlight the challenge of accurately calculating the private sector's level of risk aversion ex ante. The level of interest and enthusiasm, in light of the riskiness of legacy securities during the financial crisis and the significant regulatory and political uncertainty private partners felt, raises the question of whether the government "overshot" the subsidy level needed to induce private participation.

132. *Additional Frequently Asked Questions*, *supra* note 64.

133. Interview with Firm K, *supra* note 58.

134. All PPIP fund managers spoke to the overwhelming attractiveness of the financial terms and stated, without hesitance, that they would participate in a PPIP-like program again, given similar terms. *See supra* Section III.C.

Given the economic environment during the heart of the financial crisis and the severe market disruption at the time, it is clearly understandable that Treasury believed it necessary to provide private partners with more favorable terms than those that could be obtained in the market. However, based on anecdotal participant responses, one implication emerging from PPIP may be the usefulness of a competitive bidding mechanism, i.e., an auction, among private partners to facilitate discovery of the optimal subsidy level for PPPs going forward. An auction would eliminate the need for the government to predict the degree of risk aversion of private partners ex ante and thus reduce the likelihood of "over-subsidization."[135] This auction mechanism is akin to Professor Bebchuk's proposal whereby fund managers would submit bids indicating "(i) the minimum terms acceptable to them, as well as (ii) the size of the fund they would establish if admitted into the program."[136] Establishing a process through which private partners compete for participation in the PPP would help ensure that the government does not overshoot the amount of subsidy needed to induce the desired level of private participation.[137]

Moreover, the experience of PPIP participants suggests that the government can help keep the subsidy at a minimum by allaying private sector fears of regulatory and political risk through extra-legal mechanisms that signal the government's commitment to program terms. For instance, PPPs may be most effective when they are overseen by a relatively centralized government authority, preventing uncertainty over the consistency of official responses and commitments. Additionally, as PPIP demonstrated, consistent access to senior-level officials with private sector experience and expertise played a substantial role in building trust among private sector participants. One broader implication emerging from this is a justification for the "revolving door" phenomenon. Although concern over regulatory capture is certainly warranted when private interests and regulators become too cozy, PPIP demonstrates that a shared background can help public officials more effectively align public and private in-

135. *See Basic Public Finance*, *supra* note 1, at 3; Bebchuk, *supra* note 10, at 350.
136. Bebchuk, *supra* note 10, at 350.
137. *Id.*

centives and build trust and cooperation between the two sectors, thus reducing the public cost of PPPs.

V. CONCLUSION

Using PPPs to attract private capital for the provision of social goods and services will become increasingly important during the coming period of fiscal tightening. The PPIP experiment represents one instance in which the government successfully conveyed a social subsidy to partner private and public resources in an effort to restart the legacy securities market and increase the availability of credit. And while partnering private and public capital remains critically important in traditional areas, such as student loans and housing finance, they will become even more significant as their use expands to areas such as infrastructure and start-up ventures.[138]

Partnering private and public resources presents unique contractual challenges that require targeted structuring and execution. Thus, the experiences of participants throughout the PPIP process offer helpful insights for the implementation of PPPs going forward. Drawing upon anecdotal interviews with fund managers, Treasury officials, and legal practitioners, this Note provides an empirical analysis of the challenges that can arise in a public-private context and potential solutions in response.

The experiences of PPIP participants reveal that the fear of political risk coupled with limited legal recourse are significant concerns for the private sector, making it crucial for the government to offer sufficient market-based incentives to outweigh this risk. Strong financials also diminish the deterrent effect of possible perception-related harm and the inevitably more complex

138. The Obama Administration recently announced the Small Business Investment Company ("SBIC") initiative, which provides guaranteed leverage from the Small Business Administration to private venture funds investing in early-stage small businesses to promote "innovation and job creation." *Early Stage Small Business Investment Company ("SBIC") Initiative*, U.S. SMALL BUS. ADMIN. 1 (Jan. 22, 2013), http://www.sba.gov/sites/default/files/Early%20Stage%202013%20FAQs.pdf. Additionally, the Obama Administration's proposed "infrastructure bank" would also be predicated upon a public-private investment model, aimed at drawing private capital into infrastructure finance using government leverage or guarantees. U.S. DEP'T OF THE TREASURY AND THE COUNCIL OF ECON. ADVISERS, AN ECONOMIC ANALYSIS OF INFRASTRUCTURE INVESTMENT 19 (Oct. 11, 2010), *available at* http:// www.whitehouse.gov/sites/default/files/infrastructure_investment_report.pdf.

compliance and monitoring systems required when public funds are at stake.

At the same time, building a process whereby private parties compete for participation in a PPP through an auction-like mechanism will help ensure that the amount of subsidy transferred to private partners is kept at a minimum. Moreover, the government can help keep the subsidy at a minimum by allaying private sector fears of regulatory and political risk through extra-legal mechanisms. As PPIP demonstrated, consistent access to senior-level officials with private sector experience and expertise played a substantial role in building trust among private sector participants. Thus, credibly conveying the government's commitment to the contractual terms through continual, yet restrained, engagement by market-savvy officials is critical to reducing fears of regulatory uncertainty, and consequently, the cost of PPPs to taxpayers.

Successfully structuring PPPs will provide governments with the ability to sustainably provide public goods and invest in sectors that promote growth and development, especially in times of deficit reduction. PPP's enable the government to leverage private sector capital and expertise with public resources to deliver social benefits. Consequently, understanding the mechanisms that enable us to effectively implement public-private partnerships going forward is crucial to the growth and revitalization of the U.S. economy.