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POSSIBLE FUTURE WORK

Build-Operate-Transfer Projects

Note by the Secretariat

INTRODUCTION

1. At the Congress on International Trade Law held in May 1992 in New York in the context of the twenty-fifth session of the Commission, it was proposed that the Commission consider undertaking work in the field of the Build-Operate-Transfer (hereinafter referred to as "BOT") project financing concept. Consequent to that proposal, at its twenty-sixth session in 1993, the Commission had before it a note on possible future work (A/CN.9/378) in which the Secretariat informed the Commission that it was monitoring the work by the United Nations Industrial Development Organization (UNIDO) on the preparation of "Guidelines for the Development, Negotiating and Contracting of BOT Projects". The Commission emphasized the relevance of BOT and noted with appreciation the Secretariat's intention to present a note to the Commission on possible future work in the area. This note is intended to appraise the Commission of the current situation in this regard.

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THE BUILD-OPERATE-TRANSFER CONCEPT

2. In its most basic form, a BOT project is one in which a Government grants a concession for a period of time to a private consortium for the development of a project; the consortium then builds, operates and manages the project for a number of years after its completion and recoups its construction costs and makes a profit out of the proceeds coming from the operation and commercial exploitation of the project and, at the end of the concession period, the project is transferred to the Government.

3. In this arrangement, the repayments of any loans or returns on the investments made on the project is not guaranteed by the Government, but depends on the revenue generated by the project. Since direct funds from the public budget are not required, the Government of a country will thus experience reduced pressure of public borrowing, while allowing the transfer of the industrial risks and also of new technologies to the private sector. Furthermore, since the project is built and, during the concession period, operated by the consortium, the Government gains the benefit of private sector expertise in these areas.

4. Although BOT projects have largely been used in the development of large infrastructural projects such as telecommunications networks, highways and other public transportation projects, port facilities and in energy supply, increasingly it is also being utilized for medium and small scale projects. Thus, the potential exists for BOT to provide added opportunities for increased international trade.

5. BOT projects are attractive for a number of reasons. Amongst these are that they provide countries with decreasing borrowing capacity and declining budgetary resources an opportunity to finance projects without involving public funds. Also, they offer the benefits of stimulating investments and promoting privatization. Therefore, an increasing number of States, in particular developing countries, and lending agencies have become interested in offsetting such financial difficulties through BOT projects.

6. Among the main characteristics that differentiate BOT projects from other forms of project implementation are that the Government does not provide guarantees for the loans for the financing of the project, which necessitates non-traditional distribution of risks between a high number of contractually interrelated parties. Typically, the main parties in a BOT project would be: the project company (consortium), the Government, the lenders, the construction company, the insurers, the purchasers or users of the project's product. This multiplicity of parties and their interrelated contractual relationships give rise to complex and time consuming negotiations. Furthermore, the lack of expertise in putting together a BOT project, particularly within Governments, acts as a hinderance in the negotiating process.

7. The fact that the responsibility for repayment of any loans shifts from the traditional "client" (the Government) to the private consortium implies an increased risk to the lenders. Lenders are therefore placed in a situation where they have to look for additional means of reducing their risks, including insurance. This element of non-traditional distribution of risks between the various parties makes the pre-contractual stage of a BOT project usually fairly complex.

8. Another aspect that sometimes acts as a barrier in establishing BOT projects is the lack of legal certainty in some States regarding the realization of particular aspects of a project. For example, it might not be clear as to what extent private entities may draw revenue from the operations of public infrastructural projects such as operating toll roads. In light of such uncertainty, it would be difficult for the Government, for example, to issue a concession for the development of a highway BOT project since the consortium would, in most cases, only be able to ensure returns on its investments by collecting road tolls. In other instances, there might be lack of clarity as to the basis and effect of certain long term contractual assurances that the Government would need to make to the private consortium. Enabling legislation to make the underlying legal framework attractive for BOT projects may therefore need to be enacted.

THE UNIDO GUIDELINES

9. The above mentioned problems, amongst others, and the potential for the development of BOT projects, led UNIDO to initiate the preparation of "Guidelines for the Development, Negotiation and Contracting of BOT Projects". In addition to disseminating information on BOT projects, the objective of the Guidelines is to enable States and all other interested parties to devise and formulate the appropriate approach in promotion and development of BOT projects.

10. The UNIDO Guidelines will be divided into chapters entitled as follows:

Introduction to the BOT concept; Phases of a BOT project; Macro economic considerations; Role of Government; Financial analysis (feasibility study) and economic analysis; Risk allocation and management (financial structuring); Procurement issues; Transfer of technology and capacity building; Building and construction; Operation and maintenance; Transfer of ownership; Contract package and coordinating the contracts (roadmap to the required contracts); Project agreement; Conclusion (possibly including a summary of success cases).

11. The Secretariat has been monitoring the progress within UNIDO on the Guidelines. The preparation is at an advanced stage and it is expected that the Guidelines will be finalized in September 1994.

CONCLUSION

12. Although legal aspects of BOT will form part of the UNIDO Guidelines, by reason of the large scope of the Guidelines, it will not be possible to deal with some of these aspects in a detailed manner. It is the intention of the Secretariat, once the UNIDO Guidelines are finalized, to study the desirability and feasibility of further work by the Commission on some of the problems raised with regard to BOT projects. This may include, for example, the creation of an enabling legal framework for BOT projects, in particular for the concession agreement, or guidance to the parties on contracting issues, for example, by supplementing the UNCITRAL Legal Guide on Contracts for the Construction of Industrial Works.