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POSSIBLE FUTURE WORK

Build-Operate-Transfer projects

Note by the Secretariat

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## INTRODUCTION

1. At the twenty-seventh session in 1994, the Commission, after consideration of a note prepared by the Secretariat (A/CN.9/399), emphasized the relevance of build-operate-transfer projects (BOT) and requested the Secretariat to prepare a note on possible future work on the subject of BOT projects. The Commission discussed the requested note (A/CN.9/414) at its twenty-eighth session in 1995.<sup>1/</sup>
2. Wide support was voiced in the Commission for taking up work in the area of BOT. It was pointed out that the BOT project-financing mechanism had raised a considerable amount of interest in many States and that work by the Commission in that area would help such States in tackling the problems that had been identified. It was noted, however, that, since the work to be undertaken by the Commission would be partly influenced by the final content of the Guidelines to be prepared by the United Nations Industrial Development Organization (UNIDO), and taking into account that the practice regarding BOT was still developing, it would be useful to provide the Secretariat with the opportunity to study further the issues proposed for future work. It was also noted that the Commission's work would be tailored so as not to duplicate work carried out by UNIDO on BOT projects. The Commission requested the Secretariat to prepare a report on the issues proposed for future work with a view to facilitating discussion of the matter at the Commission's twenty-ninth session in 1996.
3. The present report is submitted pursuant to the above-mentioned request.

### I. THE BUILD-OPERATE-TRANSFER CONCEPT

4. BOT is essentially a form of project financing whereby a Government awards to a group of investors (hereafter referred to as "project consortium") a concession for the development, operation, management and commercial exploitation of a particular project. The project consortium, or a company established by the project consortium (hereafter referred to as "concessionaire"), in turn, undertakes to develop the project and operate the concession in accordance with the agreement between the Government and the concessionaire (hereafter referred to as "project agreement"). While the generic term used for this type of project is "build-operate-transfer" (BOT), the following expressions may also be used to describe this form of project financing: "build-own-operate" (BOO), "build-own-operate-transfer" (BOOT), "build-own-lease-transfer" (BOLT) and "build-rent-transfer" (BRT). Despite the varying denomination, all these different arrangements consist of project financing schemes by which a Government grants a concession to private entities undertaking to finance, carry out and manage a particular project. Similar arrangements are sometimes also used between a private licensor and a project developer.
5. Unlike the traditional project financing structure in which the owner (the Government) assumes responsibility for obtaining financing and guaranteeing its repayment, in BOT it is the project consortium that assumes such responsibilities. The loans are made against the project's anticipated proceeds. This provides many benefits to the host Government. Since direct funds from the public budget are not required, the project will have little impact on public debt. Private

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<sup>1/</sup> Official Records of the General Assembly, Fiftieth Session, Supplement No. 17 (A/50/17), paras. 394-400.

sector financing also generally allows for the transfer of the financial, industrial and other risks to the private sector. Furthermore, since the project is built and, during the concession period, operated by the project consortium, the host Government benefits from private sector expertise in operating and managing such projects.

6. Contracts for the construction of infrastructure or other works traditionally provide that the owner takes over the facility upon completion of construction in accordance with the construction contract. The financing is arranged by the owner who pays the contractors either by drawing money from a loan or with its own resources. In such contracts, the contractor's basic duty is to build and to equip the contracted facility, while the economic viability and profitability of the project are the concern of the owner. In a BOT project, however, the project consortium undertakes to complete a construction and to operate the facility for a certain period of time with a view to recouping its costs and gaining profit. Thus, the project consortium has a clear interest in the feasibility and design of the facility. The project consortium also has an interest in ensuring that the legal and commercial conditions for construction and profitable operation of the facility are in place and will remain basically unchanged throughout the period of the concession.

7. Chief among the factors that have led to the interest in BOT projects is the potential for mobilizing private sector resources for infrastructure development without the need for raising public debt. This element of the BOT concept is particularly attractive at a time of worldwide increase in privatization of various utilities and services previously reserved for the public sector, and decreasing availability of public sector funds for infrastructure development. Other advantages include increased private sector involvement in the management of public infrastructure, higher potential for direct foreign investment, and access to technologies and skills not available locally. Also, BOT facilities may serve as a parameter for measuring the performance of similar projects run by the public sector.

8. There are, however, several features of BOT projects that have resulted in difficulties in their conclusion. A BOT project normally involves many contractually interrelated parties. Besides the host Government and the project consortium, other parties usually include lenders, construction companies, equipment suppliers, independent capital investors and the purchasers or end users of the project's product. Often, the project consortium will itself consist of construction companies, engineering equipment suppliers and other private investors and the project operator. Investors can include institutional investors and multilateral development agencies. In addition to that, complicated financing arrangements are necessary, not only because of the large number of parties involved, but also because, with no sovereign guarantees provided, the project consortium and the lenders have to find the means to cover the attendant risks including by way of insurance and various forms of guarantees. The contractual arrangements and risk allocation schemes in BOT can therefore be quite complex and require lengthy negotiations.

9. The support of the host Government is regarded as an essential factor for the successful realization of a BOT project. The host Government not only has to authorize the project but also will be the ultimate owner of the facility. The Government has to oversee the implementation of the concession and may, sometimes, share some of the debt or participate in the investment. In order to ensure long term private sector participation, the Government has to ensure a legal climate that is conducive to long term private investment. This will range from the establishment of a

legal framework for private investments to putting in place the necessary administrative machinery for the timely, fair and objective issuance of any required approvals or licences.

10. As the potential for BOT is more widely understood, interest in the use of the BOT concept of project finance is likely to increase, not only for large infrastructure projects, such as power generation plants and transport (toll roads, bridges and railways), but also for small and medium-sized projects, such as water treatment plants, hotels or medical facilities.

## II. WORK OF OTHER ORGANIZATIONS ON BOT

### A. United Nations Industrial Development Organization

11. UNIDO has recently prepared a document entitled "Guidelines for the Development, Negotiation and Contracting of Build-Operate-Transfer (BOT) Projects" (hereafter referred to as "UNIDO Guidelines"). The final English text was in printing at the time of the preparation of this Note. French and Spanish versions will follow later.

12. The three opening chapters of the UNIDO Guidelines provide a general introduction to BOT projects. Chapter 1 ("Introduction to the BOT Concept") outlines the structure, characteristics and parties of a BOT project and also the financing techniques and legal instruments involved; it also contains a summary of the main potential advantages to the host Government of using the BOT approach for infrastructure development. Chapter 2 ("Phases of a BOT Project") briefly describes the phases of a BOT project from the initial identification and definition of the project, Government preparation for tendering, sponsor's preparation and submission of a tender, selection of the best tender, project development, construction phase, operation of the project until the transfer of the project to the host Government. The basic economic considerations in BOT projects are set out in chapter 3 ("Economic Framework for BOT Schemes"). Such considerations include the role of infrastructure in promoting a country's economic development, the potential benefits of the involvement of the private sector in infrastructure projects and the economic benefits and costs of BOT projects.

13. The next three chapters focus on the responsibilities of the Government for the success of a BOT project. Chapter 4 ("The Government's Role in Providing for Successful BOT Projects") deals, *inter alia*, with matters such as the importance of a credible legal, regulatory and administrative framework to expedite the implementation of BOT projects, the role of various forms of Governmental incentives and the requirement of an orderly and transparent BOT procurement procedure. Having set out the general responsibilities of the Government, the UNIDO Guidelines go on to examine, in chapter 5 ("Transfer of Technology and Capability Building through BOT Projects"), how the host Government should seek to derive benefits from BOT projects for the transfer of technology from the project consortium into the local economy. It also provides examples of contract clauses seeking to ensure the use of domestic goods and services and the protection of improvements and innovations made during the concession period. Chapter 6 ("Procurement Issues and Selection of Sponsors") deals in more detail with the objectives of procurement procedures in selecting the developers of a BOT project and presents a brief overview of the legal and regulatory framework therefor. It also describes competitive tendering proceedings and presents a summary flow chart of tender proceedings.

14. Three chapters are dedicated to financial and economic aspects of BOT projects. The methods for assessing the financial and economic viability of a BOT project are analysed in chapter 7 ("Financial and Economic Appraisal of BOT Projects"). This is followed, in chapter 8 ("Risk Identification and Management"), by a discussion of the main risks to which BOT projects are exposed. That chapter distinguishes between general risks associated with the political and legal environment of the host country and risks specific to the project. Lastly, chapter 9 ("Financial Structuring of BOT Projects") explains how funds are mobilized for BOT projects, describes the types and sources of capital available in terms of the level of risk that each type of capital undertakes, and outlines financial structuring techniques.

15. Contractual matters are discussed in more detail in the following four chapters. Chapter 10 ("The Contract Package") provides a brief description of major contractual arrangements involved in a BOT project, including consultancy agreements, preliminary consortium agreement, project consortium agreement, project or concession agreement, agreement of the Government to purchase the products of the BOT facility ("off-take" agreement), construction agreement, equipment supply contracts, operation and maintenance contract, insurance contracts, financing contracts. Of these interrelated contracts, the project or concession agreement, the construction agreement and the operation and maintenance contract are also discussed separately in the three subsequent chapters. Chapter 11 ("The Project Agreement") identifies the essential elements to be regulated in a project agreement, an agreement between the project consortium and the Government for the development and operation of the project. Chapter 12 ("The Construction Agreement") discusses how the construction agreement in a BOT project usually takes the form of a turnkey contract and briefly considers three main methods of establishing the price to be paid to the contractor: lump-sum or fixed price, price based on reimbursable cost plus fees, and price based on unit prices. In addition, the chapter briefly mentions some key contractual issues, such as keeping to the planned time schedule, assuring quality and proper functioning of the BOT facility, pricing and payment, subcontracting, availability of spare parts, claims by the contractor for additional payment and securing payment obligations. Chapter 13 ("Operation and Maintenance Contract") lists and briefly describes major issues that may have to be addressed in a contract between the project consortium and the company that will oversee the day-to-day operation and maintenance of the BOT facility.

16. The ultimate steps of a BOT project, namely, those concerning the transfer of the project facility to the host Government at the end of the concession period, are discussed in chapter 14 ("Transfer of Ownership"). In particular, chapter 14 considers matters such as possible extension of the concession period, terms and costs of the transfer and warranties upon transfer. The draft UNIDO Guidelines are concluded with a summary, in chapter 15 ("Some Criteria for a Successful Application of the BOT Concept"), of the basic factors that characterize successful BOT projects in developing countries.

#### B. Economic Commission for Europe

17. Under the auspices of the United Nations Economic Commission for Europe (UN/ECE) and its Working Party on International Contract Practices in Industry of the Committee on Development of Trade ("the Working Party"), a Forum on Attracting Private Investment to Large-Scale Infrastructure Projects in Central and Eastern Europe and the CIS was held in Geneva on 13

November 1995. Among other issues, the agenda of the Forum included legal and financial issues relating to private sector participation in public sector infrastructure project financing, such as what laws are required for creating reliable project finance contracts and whether a BOT law, for instance, is required (the complete agenda of the Forum is contained in the Information Bulletin TRADE/WP.5/53 of 21 July 1995). The participants in that Forum adopted a resolution recommending, *inter alia*, that:

"12. an expert group of private- and public-sector representatives be established and charged with developing guidelines on new project financing and construction budget techniques, including BOT, for the countries of central and eastern Europe and the CIS, under the aegis of the [Working Party] (WP. 5);

"13. these guidelines be publicized through seminars and through their publication by the United Nations Economic Commission for Europe, following their submission and ratification by the UN/ECE legal experts, as constituted in the [Working Party] (WP.5)" (TRADE/R.633, Annex).

18. The Working Party accepted the recommendation by the Forum for the establishment of the expert group and decided that its work should be carried out in full cooperation with the European Bank for Reconstruction and Development, which had actively participated at the Forum and had supported this initiative (see TRADE/R. 633, para. 10).

#### C. The World Bank

19. The World Bank has supported the development of individual BOT projects in a number of countries. While the World Bank may provide assistance to Bank members seeking to establish a legal and regulatory framework favouring foreign investment via BOT projects, the World Bank is not involved in an overall effort to elaborate model legislation or guidelines on BOT legislation.

#### D. European Bank for Reconstruction and Development

20. The European Bank for Reconstruction and Development (EBRD) is providing financial support to BOT projects in a number of different sectors (e.g., telecommunications, power generation, pipelines, roads, airports and air navigation systems, ports and industrial terminals, water treatment and sewerage, waste management). EBRD also plays an advisory role regarding such projects, including as to some aspects of the legislative framework.

#### E. International Federation of Consulting Engineers

21. On 30 August 1995, the International Federation of Consulting Engineers (FIDIC), a non-governmental organization with headquarters at Lausanne, Switzerland, held a workshop entitled "Privatization: New opportunities for consulting engineers". For the purposes of that workshop, the word "privatization" was understood to embrace a range of new methods of project implementation, including BOT projects. After discussion, the participants in that workshop agreed that FIDIC should draw up applicable conditions of contract for new methods of project financing.

### III. THE ROLE OF AN ADEQUATE LEGAL FRAMEWORK

#### A. Promoting the confidence of foreign investors

22. The BOT concept has so far mainly been used in the implementation of large infrastructure projects, which require substantial investment from private sources. Most of the funds used to implement such projects are generally obtained by borrowing from commercial banks and other financial institutions. However, the repayment of borrowed funds and the return on the investment take place over an extended period. The lenders to the project and the investors will therefore look for a clear sign by the host Government of its intention to encourage long-term private investments and that such investments will be protected from expropriation or nationalization without fair compensation.

23. One of the means by which the host Governments can express such intention is by providing a sound legal framework that encourages private investment and protects the recovery of the return on the investment. Most of this will be in the form of legislation that governs investments and other general commercial matters and which is not necessarily geared towards BOT projects specifically. The existence of such legislation makes it easier to negotiate specific projects. This is so because, in the absence of such legislation, the contract documents will have to cover various issues and guarantees that would otherwise be covered by legislation, thus adding complexity to the negotiations.

#### B. Areas of legislation relevant to BOT projects

24. The legislation that, to one degree or another, is relevant to BOT projects falls into two categories. The first category includes legislation primarily geared towards promotion of foreign private investment. The terms of such legislation that will be of particular interest to sponsors of BOT projects and to their lenders will include provisions on private ownership of land and other assets, repatriation of profits, foreign exchange convertibility and public procurement. The second category includes the general commercial legislation of the host country, in particular, on incorporation of commercial enterprises, assignment of trade receivables and other securities arrangements, public procurement as well as an adequate framework governing commercial contracts and dispute settlement procedures.

25. In some of the areas of law just mentioned, there are harmonized legal texts, including texts related to the work of the Commission, which States would be advised to consider for adoption. Those texts include the United Nations Convention on Contracts for the International Sale of Goods, the UNCITRAL Model Law on International Credit Transfers, the UNCITRAL Model Law on Procurement of Goods, Construction and Services, the UNCITRAL Model Law on International Commercial Arbitration, the United Nations Convention on Independent Guarantees and Stand-by Letters of Credit and the Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

26. Beyond the need for such general legislation, there is often a need to provide more specific



legislation for the implementation of certain aspects of BOT projects. Such legislation not only provides clear signals to potential investors of the interest of the Government in carrying out BOT projects but also facilitates private sector participation in public sector projects. For example, in most States, public infrastructure has traditionally been financed and run, to a large degree, by public sector institutions usually operating as monopolies. In most such instances, there might be a need for providing a legislative basis for private sector participation and, in particular, the right to charge the public for the use of the facility to be built or for its product. Some of the other topics that may usefully be dealt with in such BOT legislation are outlined below in paragraphs 31 to 84.

### C. Existing approaches to BOT-related legislation

27. Legislative approaches differ among those States that have enacted legislation for BOT projects. Some States have adopted legislation aimed at regulating the implementation of BOT projects generally. In some cases, such legislation sets out general parameters within which Government agencies can negotiate BOT contracts. This has the advantage of providing flexibility to negotiate the contracts in a way that suits the particular circumstances of each project. Typical provisions of such legislation include, for example: the authorization to grant concessions to the private sector for BOT projects, an indication of those sectors in which BOT projects may be carried out, general rules on how financing may be raised and on incentives that may be granted to entities that wish to carry out BOT projects (including various forms of tax relief). Provisions on procurement, including on methods of solicitation and evaluation of tenders or proposals, are sometimes also included in such legislation.

28. National legislation is in some States enacted to regulate the implementation of BOT projects in particular sectors (for example, power generation, water treatment, toll roads, mass transportation). Typically, such legislation will include provisions on which types of facilities in the regulated sector can be built by way of BOT, the extent of Governmental involvement (including facilities or premises that may be granted by the Government to the project consortium), issuance of approvals for profit recovery (possibly including detailed calculations on the prices that may be charged for the product of the project). Such legislation sometimes also includes special provisions on how procurement for the projects is to be carried out.

29. Another legislative approach to BOT projects is to adopt a piece of legislation on the implementation of a specific BOT project, leaving for the parties to negotiate only the details of its execution. Typically, such legislation will define the basic content of contractual obligations for the implementation of the project, including such matters as the maximum period of time for which concessions may be granted, extent of possible Government support, procurement rules, the means of debt repayment and repatriation of profits, and conditions for the operation and transfer of the project.

## IV. OUTLINE OF MATTERS COVERED BY NATIONAL LEGISLATION

30. With a view to facilitating the discussion of the possible scope of a text that the Commission may wish to elaborate in this field, the following paragraphs 31 to 84 provide an outline of issues and legislative solutions found in national laws. In preparing this report, the Secretariat examined legislative and regulatory texts, as well as drafts of legislation relating to BOT type of projects, from some twenty-four countries. It should be noted that, as many countries do not have specific legislation concerning BOT projects, the legislation examined by the Secretariat include other

national laws and regulations potentially relevant for the execution of infrastructure projects under a BOT-type of arrangement, such as laws and regulations on procurement, concession of public services and public utilities.

## A. General provisions

### 1. Fields of concession

31. Many national laws enumerate the areas in which a concession can be granted, such as power production and distribution, water treatment systems, transportation facilities, telecommunications and minerals' exploitation. Some laws state that a concession may be granted where the State has a monopoly established by law. There are also provisions restricting concessions for reasons of national security.

### 2. Statements of policy

32. Some laws include hortatory provisions expressing principles to be borne in mind when governmental agencies plan and enter into BOT arrangements. Such provisions may be limited to general statements of policy (e.g., to the effect that governmental organs are encouraged to open markets and industries to private and foreign investment) or may be complemented by factors to be taken into account in a decision whether to grant a concession (e.g., showing that savings will be achieved by granting a concession to a private entity, or the effect a BOT project will have on the transfer of technology or the quality of services).

### 3. Competent governmental body

33. A number of laws establish a new governmental body authorized to enter into a project agreement, whereas other laws delegate that authority to already existing public bodies. According to some laws, a concession requires consent of a higher body such as parliament, council of ministers or a supervisory authority.

34. In addition to requiring authorization for a concession, national laws often require licences for activities carried out in the context of a BOT arrangement, such as the use of public land for specific purposes or installation of some equipment. The authority to issue such licences may lie with different bodies at different levels of Government. The following are examples of provisions designed to facilitate and expedite obtaining such licences: provisions requiring the listing of all necessary licences in the concession instrument; provisions directing a specified body to monitor the issuance of approvals and to help the concessionaire in dealing with the bodies competent to issue licences; provisions that channel, for the purposes of concessions, the issuance of licences through one body; and provisions on deadlines for acting on a request for a license.

### 4. Planning and coordination

35. In view of the role BOT transactions may play in the national or regional economy, laws provide various means of planning and coordinating such transactions, such as setting up a master-plan for projects that could be the subject of a concession; empowering one organ to authorize

BOT arrangements; obligating that organ to consult with specified other bodies before giving the authorization; making a concession dependent on consent of a local government, if the concession concerns an activity carried out by a body of that local government; imposing a duty to notify specified public bodies about a proposal for a BOT project and to publish such details of proposed projects that are of interest to the public or potential investors; obligating public bodies to coordinate the measures they take in case of unforeseen changes in a BOT project.

36. Furthermore, for the cases of several independent but technically related BOT arrangements (e.g., in the area of telecommunications services), there may be a need for coordination among the concessionaires or prospective concessionaires with a view to ensuring compatibility of technical solutions used. Such coordination is sometimes promoted by requiring that the project agreements contain appropriate provisions on coordination or by providing for proposals to be made to concessionaires.

## 5. Publicity and confidentiality

37. Laws seek to balance the interest of the Government or the public in having access to certain information concerning BOT projects against the concessionaire's interest in keeping information confidential. It is provided, for example, that the fact that the concession has been granted and specified clauses in the project agreement must be published in a publication or must be accessible to the public. Sometimes the persons that have access to the documents are defined more restrictively, e.g., by reference to the kind of interest they have in the project. In some countries, special registries for concessions are kept and the validity of the contract is made dependent on the registration. On the other hand, some laws guarantee confidentiality of the information that the concessionaire is not required to publicize, for example, by providing that Government officials who have access to information relating to the concession are obligated to maintain such information confidential.

### B. Award of the concession

#### 1. Prerequisites and conditions

38. Because of the high investment costs and the need to ensure financial viability of the concessionaire, some laws require that the capital of the company operating the concession (equity capital) is to be not less than a certain percentage of the whole investment. Some laws provide that the project consortium shall be solely responsible for obtaining the required financial means, or limit any public investment to a certain percentage of the whole investment.

39. Many laws contain eligibility criteria and other requirements concerning the shareholders in the concessionaire. Such provisions, for example, expressly allow foreigners to hold shares in the concessionaire; restrict foreign ownership to a certain percentage and reserve the rest for domestic investors; prohibit the participation of persons who are related to the Government (e.g., experts engaged by the Government, public officials, elected representatives and their relatives); oblige the shareholders to disclose their affiliations with companies carrying out the same activity as the concessionaire; confer special preferences to shareholders such as municipalities of the host country regarding, for example, voting rights or rights in new emissions of shares; establish the responsibility of the shareholders for the preparation of the final account of the project, which is to be presented to the Government upon expiration of the concession period or termination of the concession.

## 2. Preferences to domestic entities

40. Several provisions could be identified which give preference to domestic entities in the context of granting a concession. This is either done within the process of selecting the concessionaire or by obliging the already selected concessionaire to give preferences to domestic third parties. Some laws establish the special obligation of the procuring body to inform all potentially interested domestic entities about a specific project and about the invitation to submit tenders. In addition, when equally advantageous tenders are submitted, the tender of the domestic entity might prevail. Furthermore, laws might include provisions giving preference margins to those tenderers who undertake to employ domestic labour force, contractors or products.

41. Another way to ensure preference for domestic entities is to oblige the concessionaire to make use of domestic products. The same approach can be found regarding the employment of domestic labour: some laws state that in specific phases of the project the concessionaire has to employ domestic personnel. As to the question of what is considered to be a domestic entity, the laws differ: some refer to the ownership, some to the legal status.

## 3. Selection of the concessionaire

42. A common feature of the laws analysed are provisions on the selection of the concessionaire. A number of laws give the Government considerable freedom in choosing the method of selection, including direct negotiations with one or several prospective concessionaires. Other methods dealt with are similar to those that are described in the UNCITRAL Model Law on Procurement of Goods, Construction and Services as tendering, restricted tendering, two-stage tendering, request for proposals.

43. Under some national laws, it is in principle obligatory to use public tendering. Exceptionally, the use of direct negotiations instead of public tendering is authorized, for example, when a previous public tender was not successful, when the project is to be financed completely from private sources, or in case of unsolicited proposals for BOT arrangements.

44. Laws typically include a list of topics to be mentioned in the invitation to submit tenders and to be considered in evaluating the tenders. These include, for example, the structure of the price to be charged by the concessionaire, possibility of increases of that price, governmental subsidies to be granted or expected to be granted to the concessionaire, the degree of exclusivity to be enjoyed by the concessionaire in operating the project, duration of the concession period, termination of the concession, transfer by the concessionaire of the project to the Government after the end of the concession period.

45. In case of unsolicited proposals, some laws allow direct negotiations with the prospective concessionaire, while others require that, if the Government is willing to grant a concession of the kind proposed, public tendering should be carried out on the basis of technical solutions of the unsolicited proposal. In such public tendering, some laws allow a margin of preference (e.g., 10%) to the tenderer that had submitted the unsolicited proposal. The purpose of the margin of preference is to compensate that tenderer for the costs of preparing the unsolicited proposal and to provide an incentive for submitting such new proposals.

46. In many cases the company that will operate the concession has not yet been established at the time of the selection of the project consortium that will finance the project. Therefore, some laws deal with the obligation of the consortium to found that company (concessionaire) within a specified period after the selection of the consortium. Failure to establish the company within the time period typically leaves the Government free to grant the concession to another entity.

47. It appears that, except as noted below, the policies underlying the provisions in national laws on the selection of the concessionaire are broadly the same as those on which the UNCITRAL Model Law on Procurement of Goods, Construction and Services is based. A specific consideration characterizing the process of selecting the concessionaire is the particularly high cost of preparing the technical, commercial and financial elements of a BOT project, which is the reason for a margin of preference given to the prospective concessionaire who has submitted an unsolicited proposal. Another specific consideration may apply when several BOT projects are to be implemented in an industrial sector where competition is limited (e.g., telecommunications or supply of water, gas or electricity). In such cases, if the Government has an interest in fostering competition in those areas, it may wish to grant the concessions to more than one project consortium, even if the evaluation of other elements of their proposals would suggest granting the concession to one concessionaire.

#### 4. Selection of subcontractors

48. The following types of provisions on the selection of the concessionaire's subcontractors may be found in laws: an obligation to specify in the tender the percentage of the total value of work that will be subcontracted; an obligation to identify the subcontractors before being granted the concession; a minimum percentage of the value of the project that must be subcontracted to companies that are not affiliated to the project consortium; an obligation to use competitive methods, including tendering proceedings, for selecting subcontractors. Some laws contain provisions that favour subcontracting to companies from the country where the project is to be implemented (e.g., particular measures to notify potential domestic subcontractors or participation of domestic subcontractors as an evaluation criterion for selecting the concessionaire).

49. An international financing agency provides in its guidelines on BOT related procurement that, if the concessionaire has been selected by a suitable competitive method, the concessionaire is free to select subcontractors, whereas if a competitive method has not been used for the selection of the concessionaire, such methods must be used for the selection of subcontractors.

#### 5. The project agreement

50. The range of issues to be covered in the project agreement between the Government and the concessionaire may sometimes be provided by law. Thus, some national laws require that the project agreement define the activities that are the subject of the concession. Some laws require that the project agreement contain provisions on financial matters, such as the type and amount of financial guarantees given to the Government for the performance of the project agreement, the concessionaire's right to the benefits obtained from the activity that is the subject of the concession, the concessionaire's obligation to pay any concession fee to the Government, the criteria or method for determining and adjusting the price to be charged by the concessionaire. National laws may also mandate that the project agreement provide for some degree of supervision by the State.

51. Some national laws may further define the rights and obligations of the parties by requiring that the project agreement provide for matters such as quality standards and performance control, compensation to the concessionaire for additions or improvements to the facility, the concessionaire's liability for failure to meet its obligations under the project agreement, including penalties or liquidated damages in case of breach of contract, consequences of a delay in the completion of the project, revision and amendment of the project agreement, early termination and settlement of disputes.

52. National laws also prescribe that the project agreement stipulate the preference, if any, given by the concessionaire to the employment of domestic labour and domestic suppliers, training of employees or any requirement related to the protection of the environment, areas protected by law, national security and public order.

### C. Rights and obligations of the concessionaire

#### 1. Nature of the concession

53. Several laws include provisions defining the legal regime of the concession and the nature of the concessionaire's rights. For instance, some laws provide that the concession concerns a public service, that it is exercised on behalf of the State, or that the right conceded has to be exercised in conformity with the public interest. Furthermore, national laws generally provide that the State retains the ownership of all public assets involved in the concession, while the concessionaire is only granted the right to use and possess those assets.

#### 2. Obligations

54. Many laws include provisions defining the obligations of the concessionaire that arise out of the project agreement. These refer basically to the duty to implement the project and provide the relevant service in an adequate and diligent manner according to the provisions of the project agreement. National laws may also impose more specific obligations upon the concessionaire, such as the obligation to purchase some type of insurance, to provide guarantees for the completion of different project phases (e.g. by a performance bond), to use and transfer new technology in the implementation of the project, to take good care of any public property.

#### 3. Ancillary revenue sources

55. The concessionaire, in addition to pursuing the core of the concession, might be able and willing to pursue other activities in order to generate additional income. For example, in connection with a concession to build and operate a toll road, the concessionaire may be given permission for land development alongside the road so as to supply fuel, provide car servicing, sell publicity space, or run motels, restaurants or shops. Such ancillary activities may enhance and diversify the sources of income of the concessionaire enterprise and thus offset the concessionaire's risk that the revenue from the basic concession activity would not be sufficient to provide a reasonable rate of profit. Profitable ancillary activities may also serve as an alternative for governmental guarantees.

56. In some national laws it is expressly provided that the concessionaire is allowed to pursue only the activities of the concession and those functionally connected with the core activity. Other laws mention the possibility of authorizing the concessionaire to provide ancillary services. In that connection, it is provided that the Government, in evaluating the tenders by prospective project consortia, will also take into account the number and magnitude of the ancillary services that tenderers expect to be allowed to provide. Some laws mention that the concessionaire may or may not be given a degree of exclusivity with respect to providing ancillary services. For cases where the concessionaire is engaged in ancillary activities, provisions also exist to the effect that the concessionaire must not, directly or indirectly, by way of contract or through the use of technical specifications, compel the purchasers of its core goods or services to purchase from the concessionaire also ancillary equipment or maintenance services.

#### 4. Assignment, subconcession, encumbrances

57. National laws provide divergent answers to the possibility of assignment, whether partial or total, of the concessionaire's rights. While some laws authorize such assignment, normally subject to prior governmental approval, others prohibit any form of assignment. Different solutions can also be found among those laws allowing assignment. Some national laws only permit complete assignment of the concession, including all the rights pertaining to it, while the laws of other States authorize partial assignment of some rights.

58. Similarly, national laws are not unanimous as to whether the concessionaire may award subconcessions. Some laws require prior governmental approval for any subconcession, while others expressly reject such possibility.

59. Some laws authorize the concessionaire to offer the assets and premises that are the object of the concession as collateral for the concessionaire's obligations. In such cases, some laws require, however, that those assets and premises continue to be used for the purposes of the concession.

#### D. Governmental obligations and undertakings

##### 1. Financial incentives and guarantees

60. Notwithstanding the fact that one of the main purposes of BOT projects is for Governments to avoid having to mobilize public money for a project, there are many BOT projects where the Government provides some sort of financial support to the project. Incentives offered by the Government include subsidies, no-interest loans, exemption from stamp duties and other fees, exemption from, or preferential rates for, import duties on equipment used in the project, or even some type of insurance coverage by the State. In some cases, the Government is, to a limited degree, providing guarantees. The Government may guarantee, for example, the right of the project consortium to convert the currency earned through the BOT project into another currency (usually a freely convertible one) or the availability of sufficient foreign currency for such conversion. The Government may also guarantee the right to transfer proceeds from the project to a foreign country, the right to sell a certain amount of goods or services resulting from the BOT project to a Governmental agency (so as to ensure a minimum flow of income to the concessionaire), or the availability of short term financial loans or guarantees for such loans in case of cash-flow difficulties which arise from extraordinary and unforeseen circumstances. The Government may further guarantee the repayment of a part of loans given to the project consortium, or guarantee that the price of goods or services supplied to the Government by the

concessionaire (or the price charged to customers subject to price control of the Government) will be sufficient to cover the costs and provide a reasonable rate of return.

61. Some other laws do not specify the type of guarantee that the Government is authorized to provide. Laws of this group may limit themselves to mentioning that Governmental guarantees may be given, or that guarantees, if granted, should be spelled out in the project agreement, or that, in evaluating offers from prospective concessionaires, the Government will take into account the Governmental guarantees requested. Finally, some laws, apparently motivated by the consideration that BOT projects should not engage public money, exclude such incentives altogether, or limit them to a certain percentage of the whole investment or of the equity capital of the company operating the concession.

## 2. Assurances

62. In addition to possible financial guarantees, laws often include provisions for other kinds of assurances by the Government. Laws provide, for example, that the Government will treat preferentially the concessionaire in respect of rights to use land, roads and other supporting public facilities; that the Government will use reasonable endeavours to build the infrastructure necessary for a satisfactory operation of the BOT facility (e.g., road links, terminals); or that the project agreement may stipulate that certain conditions will be maintained and that, should such conditions change, the concessionaire is entitled to compensation, readjustment of its remuneration or even termination of the project agreement. Furthermore, there are provisions similar to those typically found in investment protection treaties, including guarantees to respect private property and to ensure that any redemption of the concession will only be done by the decision of a specific body of the Government and against fair compensation.

## 3. Taxation

63. Some legislation makes provision for a preferential tax treatment of BOT projects, either by a straightforward provision or by providing that, subject to approval by a specified body, such treatment may be available. The types of tax benefits vary from country to country and may include any of the following: a preferential revenue tax, possibly staggered over different stages of the project (e.g., the preference, highest during a period after the first profit making year, may diminish with the years); a preferential tax rate for expatriated profits, if such a special tax exists; preferential turnover tax on goods or services produced at the BOT facility; exemption from custom regulations.

### E. Operation of the concession

#### 1. Price setting and price increases

64. In view of the fact that the concessionaire often operates a facility that enjoys a degree of monopoly, many laws address, directly or indirectly, the question of the prices to be charged by the concessionaire. Some laws do not address themselves the price adjustment policy but leave this issue to the project agreement. Other laws, however, establish some control system for the prices charged by the concessionaire. This is done either by price setting by the Government or a regulatory body, or by the concessionaire subject to prior approval by the Government. Lastly, in



laws dealing with specific projects or a narrowly defined area of concessions, the concessionaire may sometimes be given the freedom to charge the rate it thinks is reasonable.

65. Governmental control over price setting and price increases is subject to different rules. Some laws limit themselves to stating only that the prices must be just, reasonable or fair. Some laws state additional criteria, which might be, for example, that the prices must not exceed the amounts needed to recover the investment, cover the costs and leave a reasonable profit; that prices may be adjusted so as to reestablish the initial economic and financial balance of the contract; that the prices are to be linked to a price index; that sets of standardized quality control criteria (such as those prepared by the International Standard Organization) have to be used for measuring the quality of performance. There are also laws that mention social interests as a criterion. In addition, some laws provide the possibility to decrease prices if the concessionaire's profits are higher than a prior set rate of return on investment. Some laws restrict the frequency of price increases (e.g., once a year).

66. Some laws provide for the concessionaire's obligation to publish the prices and any changes, and for its obligation to adhere to the published prices. In addition, some laws require equal treatment of customers as regards the prices (as well as regards other contract conditions). In some cases, different treatment of specified categories of customers is allowed. When the concessionaire supplies different types of goods or services, there are also provisions dealing with the possibility of "internal subsidizing" in the sense that one price may be reduced, provided another one is appropriately increased. One law provides that if the Government determines a price that is below the level stipulated in the contract (which might occur, for example, because of social concerns) the State will pay the difference. One law provides for conciliation and specifies the composition of the conciliation panel and the conciliation procedures, in order to facilitate agreement on the price between the Government and the concessionaire.

## 2. Monitoring of project implementation

67. While national laws often give the Government some level of control and monitoring over the concession, the particular control and monitoring mechanisms may differ considerably from case to case. Some laws simply require that the project agreement stipulate some type of control by the Government. Other laws include provisions establishing a general monitoring right for the Government and even identifying various specific rights, such as the right to have access to all documents and records, to enter the property of the concessionaire, or to obtain periodic reports from the concessionaire. In some cases, the Government is given the right, under differing conditions and circumstances, to temporarily assume the control and operation of the project. Some national laws further provide that the Government shall hold a "golden share" in the concessionaire company which gives the Government the right to veto corporate decisions, such as changes of capital or transfer of shares. Moreover, some laws provide for the establishment of a separate agency or the office of a special inspector.

68. Furthermore, some laws give the Government the authority to require changes in the project, in case the original plan is deemed to be insufficient or if the public interest so requires. In such cases, some laws provide for compensation for the concessionaire's added costs, while other laws refer this matter to the project agreement or give the concessionaire the right to withdraw from the contract.

## F. Relations with customers

69. A number of national laws contain specific provisions dealing with customer issues. The following are examples of provisions in national laws that protect customers of the concessionaire: the obligation to conclude a contract with all interested parties, the duty not to discriminate any user group, the obligation to publish the general conditions and prices used by the concessionaire, provisions requiring submission of the general conditions to a competent body for approval, the obligation to issue receipts if so requested by the customer, the obligation to have in place an internal review procedure in case of complaints by customers, the right of the customers to direct complaints concerning the concessionaire's activities to a public body, and, as provided in some laws, the obligation of that body to investigate the complaint and take a decision.

## G. Relations with competitors

70. Some laws provide that, as a condition for granting a concession, the concessionaire must enter into agreements, the features of which are specified in the concession, with competitors providing the same or similar services or goods as the concessionaire. Such agreements may concern the use of the same technical standards, or, for example in the area of telecommunications, the obligation to share communications infrastructure.

## H. Performance by the concessionaire

### 1. Breach of the agreement

71. A number of laws limit themselves to requiring that the project agreement deal with the breach of the agreement by the concessionaire and the consequences of the breach (in particular payment of penalties or liquidated damages, termination of the agreement, the right to demand payment under the guarantees given to the Government).

72. Other laws, in addition to requiring that the agreement deal with these matters, distinguish between a breach committed during the construction period and a breach during the operation of the project, give examples of the two kinds of breach and provide for different consequences according to the case.

73. Other laws deal with the breach in the context of termination of the project agreement and provide examples of breach that may result in termination (e.g., failure to accumulate the finance to construct the facility, to prepare the technical documentation required to commence the construction works, to observe the technical regulations in carrying out the construction, to complete the investment process in time, to maintain the facility in accordance with the agreed standards, to provide agreed information to the Government, to meet the minimum standards of the services as required by the agreement, or charging of higher prices than permitted under the agreement). Some laws provide that the project agreement may be terminated only in cases of a grave breach of the agreement.

74. Some laws oblige the concessionaire to indemnify the Government for any claims against the Government raised as a result of the activities of the concessionaire.

## 2. Impediment

75. There is wide divergence in national laws dealing with circumstances that impede the performance by the concessionaire under the project agreement. Some laws provide for the termination of the project agreement in case the concessionaire is rendered unable to perform due to an unforeseeable change of circumstances beyond the concessionaire's control. Other laws provide for an extension of the concession period, so as to give the concessionaire the opportunity to adjust to the new circumstances. In that event, some laws contemplate some form of financial assistance by the State, while other laws exclude any form of assistance not originally provided for in the project agreement. Another group of national laws authorizes a revision of the project agreement so as to reflect the change in circumstances.

### I. Termination of concession

#### 1. Common grounds for termination

76. Various grounds can be found in national laws for the termination of the concession. Commonly, national laws provide for one or more of the following grounds: mutual consent, expiry of the concession period, death, dissolution or bankruptcy of the concessionaire, repurchase of the concession by the Government, expropriation or other form of seizure by the Government, change of governmental plans and priority, in case of public interest, national defense or security, major breach of the agreement by either party.

77. Some laws provide for the consequences of termination, depending on the reason therefor. In case of insolvency, for instance, some laws provide the possibility of a so-called "step-in" right in favour of interested third parties (normally creditors of the concessionaire), which may include a right to claim the transfer of the concession.

#### 2. Extension

78. The extension of the concession beyond the expiry of its term is a possibility which is not equally accepted in national laws. Some laws authorize an extension only if expressly permitted in the project agreement and under specific circumstances. Other national laws generally authorize the Government to grant an extension of the concession, provided that the concessionaire is not in breach of any of its main obligations. Some national laws impose a limit on the maximum period of extension, or provide for only one extension without public tendering. Some national laws, however, give the concessionaire a right to an extension of the concession under the same terms, or provide for an automatic renewal of the concession, if neither party gives notice of termination.

### 3. Transfer of the facility to the Government

79. A common feature of the laws examined is to provide for a transfer of the complete project to the Government, free of charge and liabilities, upon expiry of the concession period. In addition, some national laws provide for a transfer before the expiry of the concession period by means of repurchase by the Government and payment of reasonable compensation to the concessionaire.

80. Various solutions are found, however, as to the procedure for such transfer. While some national laws provide that the transfer takes place automatically at the end of the concession

period, other national laws require the execution of some form of act of transfer by the concessionaire. National laws also differ regarding what assets are to be transferred. Some laws distinguish between assets which were originally attached to the concession, and which have to be returned to the Government, and assets which were acquired during the concession period and meant for its operation, which the concessionaire may retain or regarding which the concessionaire may claim compensation.

81. Some national laws give the Government an option to require, instead of the transfer, the complete removal of the project facilities at the concessionaire's expense, in the event the Government at the end of the concession decides that it is not in the national interest to keep the project facility.

## J. Miscellaneous provisions

### 1. Governing law

82. Many of the laws analysed include provisions on the law governing the project agreement. Some laws provide for the applicability of the law of the State that is granting the concession. Some of those laws specify that a concession is a private law agreement, to which the law of contract applies, while others provide that a concession is a matter of public law and that administrative law applies.

83. Other laws expressly allow the choice of a national law other than the law of the State granting the concession; some of those laws indicate issues to which the law of the State granting the concession will apply, notwithstanding an agreement on the applicable law (e.g., the transfer of technology, accounting, statistics, labour relations, foreign exchange controls, export and import regulations, residency of persons and travel regulations). There is also a law providing that, in addition to using a national law for certain issues, recourse may be had to the relevant principles of international law and, if the parties in dispute so agree, to the principles of equity.

### 2. Settlement of disputes

84. Some laws state that the project agreement is to contain a dispute settlement clause without specifying anything further about the content of the clause. Other laws provide that any disputes will be settled by the competent courts of the State granting the concession. Yet other laws expressly allow submitting a dispute to arbitration; according to one law, arbitration may be agreed upon as long as this has been stipulated in the invitation to tender; another law provides that any arbitration is to take place in the State that has granted the concession. There are also laws that provide that conciliation should be attempted before resorting to the procedure for a binding settlement of the dispute.

## CONCLUSION

85. BOT transactions can play a major role in the economic policy of a State. In the experience of a good number of States, it was necessary, in order to attract investors for BOT projects, to adopt legislation on such transactions. A brief survey of such legislation is contained above in chapter IV.

86. Solutions included in national laws show different approaches, as well as different levels of detail and sophistication. While some States have enacted general legislation on BOT projects, others have adopted specific legislation on various industrial sectors, such as power generation, development of maritime terminals or water treatment. In some cases, laws were adopted for individual BOT projects.

87. National laws also provide different solutions to apparently similar or identical issues and those solutions are likely to have an impact on the country's ability to attract foreign investment through BOT projects. These differences may result from differences in underlying policies; those policies, and how they are expressed in legislative form, may also be influenced by whether the law applies to BOT transactions in general or whether it is limited to BOT projects in a specific industrial sector. To a certain extent, however, varying national solutions may also occur because drafters of the laws did not have access to the experience and solutions in other States, and did not have model solutions available, in particular solutions that are internationally harmonized.

88. As noted above in paragraphs 11 to 21, the organizations that have done work in the area of BOT transactions are not working to provide comprehensive guidance to national legislators regarding BOT projects.

89. The Commission may wish to conclude that it would be useful for States to have legislative guidance in preparing or modernizing their legislation relating to BOT projects, and that the Commission should prepare such guidance.

90. As to the form of such guidance, the Commission may wish to consider that any preparatory work should aim at providing a guide for legislators by describing legislative objectives, considering possible solutions for achieving those objectives and discussing their advantages and disadvantages. In the light of the progress of the work, the Commission might wish to determine whether it would be feasible and desirable to prepare model legislation.

91. Should the Commission decide to undertake work in the area of BOT, it may wish to request the Secretariat to review, with the assistance of an expert group and in cooperation with other international organizations having the expertise in BOT arrangements, possible issues on which legislative guidance may be useful and prepare first draft chapters of a guide for consideration by the Commission. As to the scope of the work, the Commission may wish to consider that, at least initially, the work should be geared to BOT projects in general. It could then be decided during the preparatory work whether it would be useful to add special considerations or model provisions relating to specific industrial sectors.

92. As for any work on contractual aspects of BOT, the Commission may wish to request the Secretariat to continue monitoring the work of other organizations, such as the Economic Commission for Europe and the International Federation of Consulting Engineers (FIDIC). In the

light of their work, the Commission might at the appropriate time consider forms of cooperation with those organizations (e.g., review of their draft and recommendations thereon by a Working Group with a view to later endorsement by the Commission). The Commission may also decide to prepare itself a legal guide on selected types of contract clauses in project agreements between Governments and concessionaires that give rise to particular difficulties.

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